Erste Sector Healthcare

2012 CEE Pharma interim health check

Times of uncertainty speak in favor of investment in solidly fundamentally positioned and relatively recession-proof top CEE pharma stocks. Egis, Richter and Krka continue to top our recommendation list.

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Antibiotice, Biofarm contribution
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Hungarian pharma companies' results are set to be buoyed by the weak forint this year. The medium- to long-term prospects of **Richter** are poised to benefit from their R&D foray, while new supply/distribution cooperation deals (Celltrion, Watson) should brighten **Egis**' outlook. As the current share prices of both Hungarian pharmas still fail to adequately reflect the related positive news flow or the fundamental impact of these developments**, we think that our Buy calls for Richter (with a revised target price of HUF 50,200 per share) and Egis (with a revised target price of HUF 22,850 per share) are fully justified**.

We believe that **Krka**'s 2012 results will be solid, bolstered by its patent expiration-oriented strategy in the West and renewed dynamism in the East. While the Warsaw listing has yet to show its benefits, **our revised target price of EUR 69.5 per share (only slightly down compared the previous target of EUR 73.5 per share) indicates high untapped potential; we stick to our Buy recommendation**.

Although the initial gains from the Actavis cooperation deal will lift **Bioton**'s results into the black in 2012, the stability of the turnaround has yet to be proved. Given the company's track record of delays in the execution of the earlier announced deals, we recommend that investors wait for more tangible results of the business transformation strategy. **With our new DCF-derived target price arriving at PLN 0.07 per share, we leave our Hold recommendation unchanged.**

While both **Romanian pharmas** are trying to export out of their troubled home market, which is plagued by the clawback tax as well as persisting receivables collection problems, with its significantly lower exposure to the Rx segment, as well as better financial position (allowing for a generous dividend policy), **Biofarm remains our preferred Romanian pharma sector choice. We revise our Biofarm target price from RON 0.237 to RON 0.218 per share and stick to our Accumulate recommendation**. With the more detrimental than originally assumed impact of the home regulatory toll along with the deceleration of domestic sales to be only partly offset by expanding exports, **we cut our target price for Antibiotice from RON 0.446 to RON 0.355 and downgrade the stock from Hold to Reduce.**

Executive Summary

Recommendations and target prices at a glance

Company	Currency	Recommendation before	Recommendation now	Target price (LC) before	Target price (LC) now	Current Price (LC)	Upside potential (%)
Antibiotice	RON	Hold	Reduce	0.4460	0.3550	0.3750	-5.3%
Biofarm	RON	Accumulate	Accumulate	0.2370	0.2180	0.1825	19.5%
Bioton	PLN	Hold	Hold	0.11	0.07	0.07	0.0%
Egis	HUF	Buy	Buy	20,455	22,850	17,300	32.1%
Krka	EUR	Buy	Buy	73.5	69.5	44.2	57.3%
Richter Gedeon	HUF	Buy	Buy	47,800	50,200	38,950	28.9%

Source: Erste Group Research. Based on closing prices as of September 10, 2012.

CEE pharma stock performances were mostly lackluster thus far this year, with the deepening Eurozone crisis weighing on stock liquidity.

The 1H12 reporting season confirmed that 2012 is set to be a relatively solid year for CEE pharma companies from the business perspective.

We reviewed our models and set new 12-month target prices for CEE pharma stocks.

CEE pharma stock performances were mostly lackluster thus far this year, with the deepening Eurozone crisis taking its toll, weighing on stock liquidity and keeping share prices at depressed levels (translating into attractive valuations). Nevertheless, the 1H12 reporting season confirmed that, despite all odds, 2012 is set to be a relatively solid year for CEE pharma companies from the business perspective. Although their home CEE regional markets suffer from costs savings-oriented healthcare reforms, Russia/CIS, the crucial export territory for most of them, continues to deliver a robust performance. Furthermore, the top regional pharma companies' long-term focus on building up an innovative product portfolio is set to yield more sizable results in the near future too. Consequently, we believe that the top CEE pharma stocks - Krka, Richter and Egis - are among the most suitable investments not only for traditional risk-averse, defensive sector-oriented investors, but also for those who seek investment stories with interesting news flow-driven upside.

The 2012 interim figures clearly demonstrated the power of the persistent forint weakness on Hungarian export-geared pharma companies' performances. While the Hungarian government's cost savings measures keep biting into the local pharmas' results, their harmful impact is partly mitigated by the temporarily available R&D-based relief to the OEP payments burden and further counterbalanced by robust exports (buoyed this year by forex effects), with a solid Russia/CIS market showing playing in favor of both **Richter and Egis**. On top of that, both companies promise to offer a bonus to their loyal investors. Richter's foray into the R&D area (in cooperation with Forest Laboratories) is set to provide more concrete results as well as a trigger to its valuation/stock price soon (US FDA filing for cariprazine anticipated before the end of 2012). Egis' news pipeline contains more details on its partnership deals (biosimilars marketing/distribution deal with Celltrion, rosuvastatin supply deal with Watson). In summary, incorporating the somewhat less harmful risk-free rate, but also the negative impact of the slightly faster than originally projected forint appreciation, our new target prices arrive at HUF 50,200 per share for Richter and HUF 22,850 per share for Egis, with upside potential of 28.9% and 32.1%, respectively. Consequently, we stick to our Buy recommendations for both firms.

Driven by the strong y/y pickup in Russia/CIS, along with a healthy Western European market rise, Krka's 1H12 consolidated sales advanced 6.9% y/y to EUR 565.3mn. Although the region-wide pricing pressures accompanying healthcare reforms kept a lid on the operating profitability margin, and the regional currencies' weakness took a toll on the financial result, the company's performance was solid. **Krka** maintains its regional competitive edge; thanks to the innovative generics pipeline as well as strict cost control, the company's profitability margins remain at the top of both the region and the generics industry. The Warsaw Stock Exchange listing, due partly to its thus far rather technical nature, failed to boost the stock's liquidity. Nonetheless, we believe that the company will address the shortcomings sooner or later and that this will also help the stock to appreciate, getting to levels reflecting Krka's strong fundamentals in a more adequate way. Our revised target price of EUR 69.5 per share (factoring in the less favorable valuation parameters following Slovenia's S&P downgrade) points to 57.3% upside potential. Consequently, we confirm our Buy call on the stock.

Boosted by significant positive one-offs, in particular the Actavis cooperation contract related milestone, **Bioton**'s switch into the black is expected in 2012. The 2013 prospects are more challenging, however, as the underlying profitability remains rather weak and the benefits from the numerous cooperations in Bioton's core insulin business (with Bayer in China, with GSK in Russia), as well as the Biolek acquisition, have yet to show their transforming effect on the company's business performance. While the Actavis cooperation deal promises to make Bioton the next real turnaround story, the track record of numerous delays, along with the rather weak transparency, prompt us to keep the earlier introduced risk related discount of 10% in our DCF valuation. Our revised 12-month target price arrives at PLN 0.07per share (vs. the earlier PLN 0.11). Consequently, we leave our Hold recommendation unchanged for the time being.

While the 1H12 results of the Romanian pharmaceutical companies were relatively sound at first glance, witnessing the double-digit y/y growth tempo and healthy margins, a second look already points to the help of one-off factors (particularly in the case of **Antibiotice**) and a less encouraging outlook for the full year. The situation on the Romanian pharmaceutical market remains challenging, marked by the persistently poor payment discipline and relatively high clawback burden. Reflecting the decelerating domestic sales pace as well as the higher than originally expected clawback tax toll (depressing profitability margins), we revise our 12-month target price for Antibiotice down to RON 0.355 per share (from RON 0.446 per share) and downgrade our recommendation from Hold to Reduce. We continue to believe that **Biofarm**'s investment story retains its attractiveness. Although the mounting marketing expenses are set to put a lid on profitability margins, supported by its edge in the domestic OTC sector (which is affected to a lesser extent by the home market woes than the Rx segment) and low indebtedness, the company should be able to sustain the generous dividend program on which it embarked this year. Our revised 12-month target price arrives at RON 0.218, suggesting solid upside potential for the stock. Consequently, we stick to our Accumulate recommendation.

Valuation/Recommendation

Neither the weak forint's support to the 2012 results, nor progress on the cariprazine path to market are adequately reflected yet in Richter's share price.

A brief look at the current valuations demonstrates clearly that, despite their partial recovery, the top CEE pharma players' stock prices remain at very attractive levels that offer solid upside potential. For Richter and Egis, their Hungarian home proved to be one of the factors deterring international investors, who are often worried about the unpredictable outcome of the unorthodox government measures. On the other hand, it was the uncertainties surrounding the Hungarian economic outlook keeping the Hungarian currency rates persistently close to record highs vs. the euro and government bond yields at a significantly higher level than their CEE counterparts. While the first worked well in favor of both Egis and Richter's business results, the latter put a lid on their valuation. While the negative worries seem to have lost their dominance as of lately and both Hungarian pharma stocks appreciated, their valuations are still very appealing at the moment. Despite the recent stock rally, Egis maintains its status as the cheapest CEE pharma stock; its valuation gap remains wide, with the stock currently traded at a 25.4% discount on 2012e PER and a 18.1% discount on 2012e PCE ratios of the CEE-based peer group. We continue to believe that this is only partly justified by Egis' somewhat lower profitability parameters, which are in the medium term still suppressed by the company's relatively high domestic regulatory toll, as well as the somewhat less favorable sales mix compared to its peers (with the EBIT margin expected to return from the 2012e peak level of 16.0% to just 12.7% the following year). Although, after posting a sound 13.9% YTD performance, Richter keeps its position as the most expensive among the CEE-based pharmas, its multiples are still less demanding than those of its Western-based peers. Furthermore, we continue to think that Richter's well defined niche portfolio strategy, as well as original R&D program related triggers, justify the stock's premium. Our new target prices (HUF 22,850 per share for Egis and HUF 50,200 per share for Richter) reaffirm our view that the room for share price appreciation remains abundant. We thus leave our Buy recommendation for both Egis and Richter unchanged.

Egis' valuation gap and new catalysts in the news pipeline (biosimilars cooperation and/or rosuvastatin supplies deal) should lure more investors.

	P/E		P/CE		P/BV		EV/sales		EV/EBITDA	
	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e
Egis to CEE Peers, Prem/Disc	-25.4%	-14.1%	-18.1%	-24.9%	-24.5%	-23.4%	-46.4%	-50.8%	-40.7%	-39.6%
Egis to Western Peers, Prem/Disc	-23.1%	-7.7%	-53.1%	-33.7%	-66.5%	-69.3%	-62.1%	-63.6%	-56.7%	-51.3%
Egis to Richter, Prem/Disc	-48.4%	-40.1%	-49.7%	-44.8%	-47.4%	-47.8%	-59.6%	-59.8%	-58.4%	-54.2%

Source: Erste Group Research, Factset, based on closing prices as of September 10, 2012

Krka's stable business performance and outlook have yet to be factored into its share price. The Warsaw listing is to show its benefits in the future.

Although Krka's liquidity was supported by the company's share buyback (Krka has purchased some EUR 7mn worth of treasury shares in January - August 2012), its share price has taken a hit in 2012. In 1H12, the home Ljubljana Stock Exchange suffered more severely than its regional counterparts, with some local investment funds experiencing difficulties and the still insufficient foreign investors' presence failing to prevent the trading volumes from shrinking. As a result, Krka's multiples were sent to levels that are far from those seen in the days when Krka was the most expensive stock in the CEE region. Not only has Krka's earlier premium disappeared, but the stock is currently traded not only at a discount to its Western peers, but also compared to Richter (e.g. P/CE, EV/Sales, EV/EBITDA). The 1H12 report confirmed that, buoyed by Western European markets (maintaining their momentum) and Russia/CIS (delivering a robust performance), Krka is able to deliver on its promises. In 1H12, its top line advanced 6.9% y/y to EUR 565.3mn and net profit amounted to EUR 90.1mn, indicating that the 2012 full-year guidance (net profit of EUR 170mnon sales of EUR 1,134mn) will once again be reached or possibly even surpassed. The medium- to long-term outlook is also solid. The company boasts a very innovative generics portfolio and this (alongside the efficient cost control) provides an antidote to the pricing pressures, keeping Krka's profitability margins above its CEE-based peers'. Finally, after the technical listing on the Warsaw Stock Exchange, the company sticks to its promises to bring (with the timing depending on market conditions) the gathered treasury stock to Polish institutional investors, which should inject fresh life into the stock liquidity. Our revised target price of EUR 69.5 (vs. the earlier target of EUR 73.5) per share suggests a significant upside potential from its currently depressed levels. We confirm our Buy call on the stock.

	P/E		P/CE		P/BV		EV/sales		EV/EBITDA	
	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e
Krka to CEE Peers, Prem/Disc	-10.7%	-15.6%	1.7%	-18.6%	24.5%	23.4%	-4.9%	-5.8%	-14.2%	-19.0%
Krka to Western Peers, Prem/Disc	-8.0%	-9.3%	-41.8%	-28.2%	-44.7%	-50.5%	-32.7%	-30.4%	-37.3%	-34.7%
Krka to Richter, Prem/Disc	-38.3%	-41.2%	-37.5%	-40.1%	-13.2%	-15.9%	-28.4%	-23.1%	-39.8%	-38.7%

Source: Erste Group Research, Factset, based on closing prices as of September 10, 2012

Excluding one-offs, Bioton's multiples are the most demanding; turning numerous cooperation deals into material progress in business performance remains the key to share price appreciation / valuation of the stock.

As before, Bioton's multiples demonstrate the profound impact of one-offs on the company's results, painting a rosy picture in 2010 and 2012, but making bleak 2009, 2011 and 2013 figures. Subtracting the bolstering impact of milestones, Bioton's valuation parameters (except for the P/BV) remain the most demanding in the CEE pharma universe. In 2012, not only did the restructuring/cooperation deal related news flow intensify, but the company also recorded the first sizable payment from the recently (finally) concluded Actavis deal. Nonetheless, investors started to lose patience, with the progress (for example, in the Bayer cooperation deal in China) deemed rather slow and the conditions of the Biolek acquisition far from ideally transparent (with payments in shares in installments, depending on the achievement of certain milestones, bringing significant dilutive effects). All of this took a toll on the share price. While the medium- to long-term outlook for Bioton's insulin business remains solid both at home (with Bioton insulin product keeping its price competitiveness compared to its Western rivals) as well as on the export front (sales in China in cooperation with Bayer, in Russia in cooperation with GSK, as well as in the EU, US, Japan and other markets in cooperation with Actavis), it will be the initial milestone payment from Actavis (EUR 22.25mn) that will save the show in 2012. Nonetheless, excluding this milestone payment, the company would still end in a loss also in 2012. While 2013 is envisaged to be the first year in which the underlying profitability will improve sufficiently to provide for a more sustainable switch to black numbers, the profitability margins will remain well below those of its peers, in our opinion. Incorporating the more grim than originally anticipated underlying profitability parameters, coupled with the significant dilutive effects of the Biolek acquisition deal, our new 12-month target price for Bioton arrives at PLN 0.07 per share (vs. the earlier PLN 0.11 per share). With respect to the company's track record involving numerous delays in the execution of the previously announced transactions, uncertainties related to the company's future prospects remain rather high, we stick to the earlier introduced risk related discount of 10% for the time being. In summary, we opt to remain on the conservative side and leave our Hold recommendation unchanged.

	P/E		P/CE		P/BV		EV/sales		EV/EBITDA	
	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e
Bioton to CEE Peers, Prem/Disc	-0.3%	287.1%	-1.7%	45.1%	-59.9%	-55.7%	60.1%	71.9%	92.8%	169.9%
Bioton to Western Peers, Prem/Disc	2.8%	315.9%	-43.7%	28.1%	-82.2%	-82.3%	13.3%	27.1%	40.8%	117.6%

Source: Erste Group Research, Factset, based on closing prices as of September 10, 2012

Biofarm remains our preferred exposure to the Romanian pharma sector.

The Romanian pharma companies' valuation multiples, especially those of Biofarm, are relatively demanding in the current context of the CEE pharma universe. As per tradition, Biofarm is traded at a premium to its local peer Antibiotice. Nonetheless, with its recent share price performance bolstered by the robust 1H12 showing, Biofarm is currently not only more expensive than Egis, but also in some parameters trading at a premium to Krka. Only Hungary's Richter remains at a distance. We continue to believe that the gap between the Romanian pharma peers is fully warranted. In the current market situation, Biofarm, with its more favorable sales mix (with a high proportion of OTC drugs vs. Antibiotice's high exposure to the Rx segment), along with a far more stable financial position (practically zero external debt, while its peer is forced to take short-term loans to cover its working capital needs) represents the better choice for investors considering an investment in the Romanian pharma sector, as well as those looking for a decent (and sustainable) dividend yield in the shaky market environment. Still, Biofarm's relatively low stock liquidity continues to represent a brake for foreign institutional investors. In this respect, the situation might change for the better in the future, should the Biofarm investment story get a new impetus, thanks to its status as a possible strategic takeover target. Finally, it is worth mentioning that, despite its relatively high exposure to the problematic Romanian market, Biofarm's profitability parameters are practically on par with those of Richter at the moment. With the impact of the fierce competition on the Romanian OTC market to be largely mitigated by strict cost control and a reinforced export focus, we revise our target price from RON 0.237 to RON 0.218 per share and stick to our Accumulate call. On the other hand, although Antibiotice's multiples might seem more attractive than those of its local peer, we believe that, with its earnings outlook darkened by high exposure to the Romanian pharmaceutical market (hampered by many unresolved problems), we think that Antibiotice's share price might remain under pressure in the coming periods. Reflecting the negative impact of the more sizable than earlier envisaged domestic market burden (clawback tax, delayed payments in the public healthcare sector), alongside the decelerating domestic sales tempo (only partly offset by expanding exports), we trim our target price to RON 0.355 per share and cut our recommendation for Antibiotice from Hold to Reduce.

	P/E		P/CE		P/BV		EV/sales		EV/EBITDA	
	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e	2012e	2013e
Biofarm to CEE Peers, Prem/Disc	2.3%	8.4%	45.5%	18.6%	28.6%	37.5%	4.9%	5.8%	3.6%	3.8%
Biofarm to Western Peers, Prem/Disc	5.4%	16.4%	-16.7%	4.7%	-42.9%	-44.9%	-25.7%	-21.8%	-24.3%	-16.3%

Source: Erste Group Research, Factset, based on closing prices as of September 10, 2012

CEE pharmaceuticals valuation at a glance

	P/E				P/CE				P/BV			
	2010	2011	2012e	2013e	2010	2011	2012e	2013e	2010	2011	2012e	2013e
Antibiotice	15.1	8.3	10.1	8.8	7.4	4.4	5.2	4.7	0.7	0.6	0.7	0.7
Biofarm	16.4	13.4	10.3	10.4	13.3	9.9	8.6	7.9	1.5	1.4	1.3	1.2
Bioton	6.9	nm	10.0	37.2	5.2	n.m.	5.8	9.6	0.7	0.3	0.4	0.4
Egis	10.3	7.8	7.5	8.2	7.1	4.7	4.8	5.0	1.2	0.7	0.8	0.7
Krka	13.0	11.5	8.9	8.1	8.8	7.6	6.0	5.4	2.1	1.6	1.2	1.1
Richter Gedeon	12.2	11.5	14.5	13.8	9.2	7.7	9.6	9.0	1.8	1.3	1.4	1.3
Median CEE	**12.6**	**11.5**	**10.0**	**9.6**	**8.1**	**7.6**	**5.9**	**6.6**	**1.4**	**1.0**	**1.0**	**0.9**
Teva Pharmaceutical Industries Ltd.	9.4	8.3	7.6	7.0	9.4	8.3	6.3	6.1	1.8	1.7	1.5	1.3
Mylan Inc.	15.6	11.9	9.5	8.7	11.8	14.8	10.3	6.4	2.4	2.7	2.2	2.3
Watson Pharmaceuticals Inc.	25.6	17.8	14.4	10.5	19.8	14.0	11.9	9.1	3.3	3.0	2.7	2.3
Stada Arzneimittel AG	10.2	9.2	8.9	7.8	7.1	10.9	6.3	5.1	1.5	1.6	1.4	1.3
Ranbaxy Laboratories Ltd.	15.4	24.1	16.7	20.8	10.8	80.4	13.8	15.9	3.6	8.0	5.2	4.3
Recordati S.p.A.	10.8	9.7	9.7	8.9	8.5	8.2	8.1	7.5	2.1	1.9	1.7	1.6
Dr. Reddy's Laboratories Ltd.	22.3	19.8	18.4	16.8	19.0	15.8	13.8	14.2	5.3	4.9	4.1	3.4
Median Peer Group	**15.4**	**11.9**	**9.7**	**8.9**	**10.8**	**14.0**	**10.3**	**7.5**	**2.4**	**2.7**	**2.2**	**2.3**
CEE to Peer, Prem/Disc	**-18%**	**-4%**	**3%**	**7%**	**-25%**	**-46%**	**-43%**	**-12%**	**-43%**	**-63%**	**-56%**	**-60%**

	EV/Sales				EV/EBITDA				Dividend yield			
	2010	2011	2012e	2013e	2010	2011	2012e	2013e	2010	2011	2012e	2013e
Antibiotice	1.0	0.9	0.9	0.9	5.8	5.0	5.5	5.3	0.0%	5.2%	4.0%	4.5%
Biofarm	1.9	1.4	1.5	1.5	7.2	6.4	5.9	5.7	2.7%	5.3%	7.3%	7.2%
Bioton	2.7	2.6	2.4	2.4	7.9	-54.6	10.9	14.8	0.0%	0.0%	0.0%	0.0%
Egis	1.3	0.7	0.8	0.7	6.2	3.4	3.4	3.3	0.5%	0.9%	0.7%	0.7%
Krka	2.3	1.8	1.4	1.3	8.0	6.4	4.9	4.4	2.2%	2.7%	3.5%	3.7%
Richter Gedeon	2.7	1.7	2.0	1.7	8.8	6.0	8.1	7.2	2.0%	2.2%	1.7%	1.8%
Median CEE	**2.1**	**1.5**	**1.5**	**1.4**	**7.5**	**5.5**	**5.7**	**5.5**	**1.3%**	**2.5%**	**2.6%**	**2.8%**
Teva Pharmaceutical Industries Ltd.	3.4	2.8	2.4	2.1	9.3	8.6	7.4	6.7	1.7%	2.2%	2.4%	2.7%
Mylan Inc.	2.6	2.3	2.1	1.9	10.0	8.4	7.8	6.8	0.0%	0.0%	0.0%	0.0%
Watson Pharmaceuticals Inc.	2.1	1.9	2.1	1.4	9.0	7.9	8.5	6.9	0.0%	0.0%	0.0%	0.0%
Stada Arzneimittel AG	1.4	1.2	1.3	1.2	7.9	6.3	6.8	6.0	1.6%	1.6%	2.7%	3.5%
Ranbaxy Laboratories Ltd.	3.1	1.9	2.1	2.2	16.3	11.4	11.0	14.3	0.4%	0.0%	0.7%	0.7%
Recordati S.p.A.	2.0	1.6	1.5	1.3	7.9	6.5	6.2	5.4	4.9%	5.3%	5.3%	5.8%
Dr. Reddy's Laboratories Ltd.	4.0	2.9	2.6	2.3	19.1	11.9	12.1	11.0	0.8%	0.8%	0.8%	0.8%
Median Peer Group	**2.6**	**1.9**	**2.1**	**1.9**	**9.3**	**8.4**	**7.8**	**6.8**	**0.8%**	**0.8%**	**0.8%**	**0.8%**
CEE to Peer, Prem/Disc	**-18%**	**-18%**	**-29%**	**-26%**	**-19%**	**-35%**	**-27%**	**-19%**	**67%**	**199%**	**223%**	**234%**

	ROE				EBITDA margin				Net margin			
Company	2010	2011	2012e	2013e	2010	2011	2012e	2013e	2010	2011	2012e	2013e
Antibiotice	5.0%	7.4%	7.1%	7.9%	17.8%	17.2%	16.8%	16.2%	5.1%	7.1%	6.7%	7.0%
Biofarm	9.7%	10.4%	12.3%	12.1%	26.0%	22.5%	26.4%	25.7%	16.3%	16.6%	19.2%	17.4%
Bioton	11.3%	-7.0%	4.2%	1.1%	34.0%	-4.8%	21.6%	16.1%	24.8%	-15.5%	9.3%	2.9%
Egis	11.9%	9.1%	10.7%	8.7%	21.4%	19.9%	23.5%	20.6%	14.1%	10.5%	14.0%	12.0%
Krka	17.4%	14.9%	14.6%	14.5%	29.0%	28.0%	28.8%	29.4%	16.9%	15.1%	15.3%	15.7%
Richter Gedeon	15.8%	11.3%	10.6%	10.0%	30.4%	27.7%	24.2%	23.4%	23.5%	16.1%	15.8%	15.3%
Median CEE	**11.6%**	**9.8%**	**10.6%**	**9.4%**	**27.5%**	**21.2%**	**23.9%**	**22.0%**	**16.6%**	**12.8%**	**14.7%**	**13.7%**
Teva Pharmaceutical Industries Ltd.	18.6%	19.8%	19.6%	18.6%	36.6%	32.6%	31.9%	32.2%	20.7%	24.2%	22.8%	23.0%
Mylan Inc.	15.1%	22.6%	23.5%	25.9%	25.7%	27.2%	27.1%	27.5%	4.1%	14.6%	15.4%	15.9%
Watson Pharmaceuticals Inc.	12.9%	16.6%	18.5%	21.9%	23.5%	23.7%	24.3%	19.8%	11.9%	5.7%	13.4%	13.9%
Stada Arzneimittel AG	15.2%	16.8%	15.6%	16.1%	18.4%	19.0%	19.8%	20.3%	4.2%	1.3%	6.7%	8.4%
Ranbaxy Laboratories Ltd.	23.1%	33.1%	30.9%	20.6%	18.9%	16.3%	19.0%	15.6%	17.5%	-29.1%	12.0%	10.4%
Recordati S.p.A.	19.0%	19.9%	17.7%	17.5%	25.0%	24.7%	23.4%	24.1%	14.9%	15.2%	14.4%	14.8%
Dr. Reddy's Laboratories Ltd.	23.9%	24.9%	22.2%	20.3%	20.9%	24.4%	21.8%	21.3%	14.8%	14.7%	14.1%	13.9%
Median Peer Group	**18.6%**	**19.9%**	**19.6%**	**20.3%**	**23.5%**	**24.4%**	**23.4%**	**21.3%**	**14.8%**	**14.6%**	**14.1%**	**13.9%**
CEE to Peer, Prem/Disc	**-38%**	**-51%**	**-46%**	**-54%**	**17%**	**-13%**	**2%**	**3%**	**13%**	**-12%**	**4%**	**-2%**

Source: Erste Group Research, Factset. Based on closing prices as of September 10, 2012. All data in EUR terms.

Market Overview

1H12: CEE equity market performance lackluster; CEE pharma stocks mostly headed south; Richter topped liquidity ranking.

With the Eurozone still trying to find the way out of its biggest financial crisis thus far, worries about the public debt situation in Greece, the health of the financial sector in Spain and some other Eurozone countries, along with economic indicators confirming the earlier recessionary fears, the performance of CEE equity markets has continued in to be lackluster so far in 2012.

	LC terms					EUR terms				
	% Change 3Q11	% Change 4Q11	% Change 1Q12	% Change 2Q12	% Change YTD 2012	% Change 3Q11	% Change 4Q11	% Change 1Q12	% Change 2Q12	% Change YTD 2012
Antibiotice SA	-20.7%	-1.4%	5.5%	-17.4%	-3.8%	-23.0%	-0.7%	4.1%	-18.6%	-7.0%
Biofarm SA	-4.0%	1.5%	3.6%	-15.5%	-5.4%	-6.8%	2.3%	2.2%	-16.6%	-8.5%
BET (RO)	-22.5%	1.6%	28.3%	-14.1%	18.7%	-24.8%	2.3%	26.5%	-15.3%	14.8%
Bioton S.A.	-46.7%	-25.0%	66.7%	-30.0%	16.7%	-51.9%	-25.7%	78.9%	-31.4%	26.6%
WIG 20 Bench (PL)	-21.9%	-2.0%	6.6%	-0.5%	8.9%	-29.6%	-3.0%	14.4%	-2.4%	18.2%
Egis Plc	-25.1%	20.0%	-17.2%	0.0%	-2.3%	-32.2%	11.9%	-11.7%	3.2%	8.1%
Richter Gedeon	-17.3%	14.2%	10.7%	-1.8%	13.9%	-25.1%	6.4%	18.2%	1.4%	26.0%
BUX Bench (HU)	-30.6%	7.6%	9.8%	-10.1%	4.5%	-37.2%	0.3%	17.2%	-7.2%	15.6%
Krka	-14.4%	2.9%	-5.2%	-16.2%	-16.4%	-14.4%	2.9%	-5.2%	-16.2%	-16.4%
SBI Bench (SI)	-15.6%	-1.9%	-0.9%	-14.4%	-14.6%	-15.6%	-1.9%	-0.9%	-14.4%	-14.6%

Source: Erste Group Research, based on closing prices as of September 10, 2012

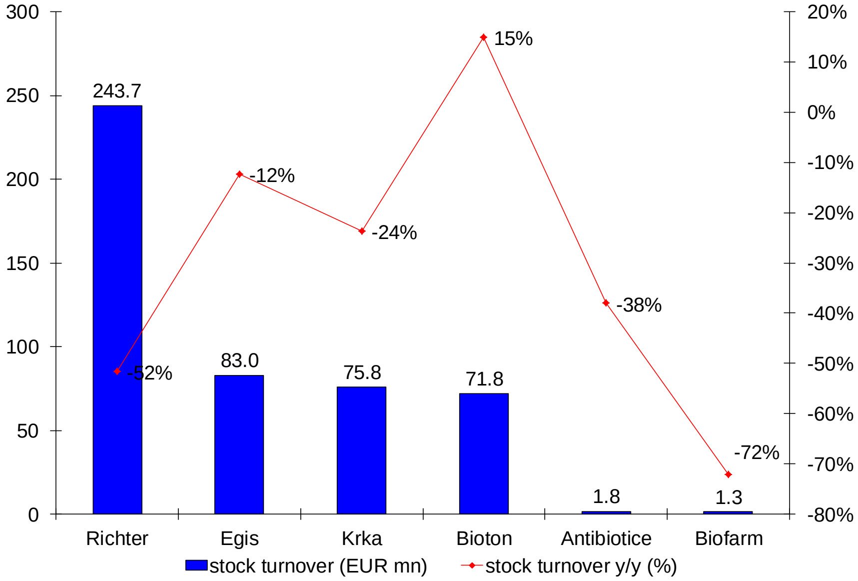
A closer look at the CEE pharma stocks' quarterly 2012 performance data clearly shows that the sector could not escape the consequences that the looming Eurozone crisis had on CEE equity markets. Only a few CEE pharma sector stocks (Richter and - surprisingly - Bioton) fared better than the respective local stock indices. After the rather uninspiring 1Q12 performance, the second quarter meltdown sent the stock prices to new lows. The unfavorable changes in the Hungarian drug market regulation, along with the negative sentiment towards their still rather challenging Hungarian equity market, put a lid on Richter and Egis' share prices. Reflecting the much bigger magnitude of the home regulatory burden on the company, Egis' share price performance lagged well behind that of its local rival. Although Egis' valuation gap was very appealing and in 2Q12 the stock partly recovered from its depressed levels, for 1H12, Egis' share price still dropped (8.8% y/y in EUR terms), while Richter managed to close in positive territory in 1H12 (up 19.8% y/y in EUR terms). While the uncertainties and diminishing appeal of the Hungarian equity market prompted many international investors to stay on the sidelines and Richter's stock liquidity contracted 51.6% y/y, with a trading volume of EUR 243.7mn, the company nonetheless maintained its top ranking in the CEE pharma universe in 1H12.

Helped by 1Q12 business results beating market expectations, the finalization of the earlier promised corporate transactions and its status as a penny stock (with positive changes in the second decimal place translating into a double-digit rise), Bioton was the best performer in the CEE pharma sector universe, surging 22.8% in EUR terms in 1H12 (vs. a WIG20 rise of 11.7%). In addition, Bioton, the only stock in the CEE pharma universe to do so, saw its liquidity improve y/y, with stock turnover expanding 14.9% y/y to EUR 71.8mn in 1H12.

With its share price declining 14.8% in EUR terms, Romania's Biofarm was this time not only the third worst performer among the regional pharmas in 1H12, but as its already meager stock liquidity fell quite considerably (by

72.1% y/y to EUR 1.3mn), the stock ended at the bottom of the regional pharma stock ranking in terms of liquidity. Antibiotice saw a less dramatic trading volume fall (of 38% y/y), but with a trading volume of EUR 1.8mn in 1H12, the company fared only marginally better than its local peer. At the same time, Antibiotice's share price slipped 15.2% y/y in EUR terms. The gathering of treasury shares (following the technical listing in Warsaw in April, the company renewed its share buyback program) did not prevent Krka's liquidity from shrinking in 1H12. Not only did its share price plunge 20.6% y/y, making it the worst performer in the CEE pharma universe, but Krka's trading volume also slid 23.7% y/y, sending it to the third position in the regional CEE pharma stock liquidity ranking, behind Egis, which it was able to overtake in 2011. Nonetheless, Krka kept its crucial importance for its home bourse. With a trading volume of EUR 75.8mn, Krka accounted for nearly 52% of LJSE equity turnover in 1H12.

CEE pharma stocks liquidity in 1H12



Source: Erste Group Research, local stock exchanges

Risk aversion and recession worries should work in favor of defensive titles, including CEE pharmas, in 2012.

Unfortunately, addressing the problems associated with the Eurozone crisis will still take time. Concerns about the public debt/banking sector situation in the most affected countries of the EU (with Greece, Spain and Italy in focus) are set to undermine investors' confidence going forward. The recession in the most severely affected Eurozone countries is becoming a reality and the CEE region is also poised to see its economic growth tempo heavily compromised in 2012, with some countries' GDP tempo slipping into negative territory this year. Nonetheless, while none of the sectors will be totally spared and savings measures also affect healthcare, given the relative inelasticity of demand, their cost competitiveness and well balanced territorial sales structure (with exposure to the still solidly expanding Russia), the CEE-based generics producers should feel relatively minimal pains. Moreover, the results of the export-geared Hungarian pharma producers will be further bolstered by their home currency weakness this year. Hence, we continue to believe that pharma stocks (in particular, the Hungarian ones, as well as Slovenia's Krka) offer good entry levels and that patient investors will be rewarded.

Going forward, we believe that, with their home political and macro-economic situation becoming more transparent and the deal with the

Hungarian pharma stocks should start to shine more brightly on investors' screens. Not only are the results set to be solid in 2012, but both Richter and Egis have more (hopefully) positive news in their pipeline.

IMF/EU reducing the perceived risks attached to investments in Hungarian assets (resulting in decreasing government bond yields in the first place and later on possibly to be accompanied by an upgrade of Hungary's rating from the current junk status by international rating agencies), Hungarian pharma stocks should start to shine more brightly on investors' screens (even though the solution to their home country's macroeconomic woes will result in a less favorable forex situation from the perspective of exporters). In 2012, the grim home market conditions, with government cost savings measures, including the tightening grip of the blind bidding auctions, will be largely compensated for by the y/y improving export prospects, fueled by the crucial Russia/CIS, with the additional help of the forint weakness. Not only are the results set to be solid in 2012, but both **Richter and Egis** have more (hopefully) positive news in their pipeline. Richter's investment story is set to get new and hopefully positive triggers from the news flow around bringing the cariprazine-based CNS drug to the US market (with the US FDA filing by Forest Laboratories to be accompanied by another milestone payment). Egis' news flow related to its partner Celltrion's progress in the EU registration of biosimilar products (to be marketed and distributed by Egis in selected CEE markets, including Russia), as well as information on the development in the rosuvastatin supply contract with Watson, are set to catch investors' attention. Consequently, we believe that, although the impact of the unfavorable home market developments is burdening Egis more than its home rival Richter, and Egis' profitability parameters remain (despite recent progress) somewhat behind the region's best, Egis' wide valuation gap to Richter and its regional peers is set to close (at least partially) in the coming period.

We believe that Krka's offering of the gathered treasury shares would be welcomed by international investors and would benefit the stock price.

The long-awaited **Krka** Warsaw listing attracted a lot of attention among market participants. Although it took place a bit ahead of the originally anticipated deadline (in April 2012, vs. the earlier announced end-June 2012 deadline), given the manner selected, i.e. just a technical listing, without offering the earlier gathered treasury shares to Polish (and other) institutional investors, it failed to provide the desired boost to liquidity. We continue to believe that this second step would be welcomed by international investors and would benefit the stock price, with the stock possibly returning to its earlier premium to its CEE-based sector peers.

The Bioton investment story remains a bit shaky, offering rather speculative potential.

With Krka's Warsaw trading activity meager, Bioton thus remains the only pharmaceutical manufacturer listed on the Warsaw Stock Exchange with reasonable liquidity. Although, over time, more of the restructuring gains and proceeds from cooperations are set to kick in and Bioton should start to deliver quarterly results that finally please market participants, the Bioton investment story remains a bit shaky, offering rather speculative potential. Long term-oriented investors are staying on the sidelines, deterred by the still cloudy outlook and opacity of the company's transformation process.

In Romania, we continue to prefer Biofarm, thanks to its dividend policy, potential strategic takeover candidate status.

While the low stock liquidity remains a brake for investments into both Romanian pharmas from the international perspective, we continue to prefer Biofarm, as we believe that the company is set to outperform Antibiotice in terms of business results (with better profitability parameters) as well as stock appeal (with a new attractive dividend policy and the possibility of a strategic takeover candidate status).

CEE pharma shares offer interesting long-term upside potential

Company	Currency	Current Price (LC)	5-year-high (LC)	Current price vs 5 y high (%)	Target price (LC)	Upside potential (%)
Antibiotice	RON	0.3750	1.7140	-78.1%	0.355	-5.3%
Biofarm	RON	0.1825	0.6210	-70.6%	0.218	19.5%
Bioton	PLN	0.07	1.32	-94.7%	0.07	0.0%
Egis	HUF	17,300	23,890	-27.6%	22,850	32.1%
Krka	EUR	44.2	124.4	-64.5%	69.5	57.3%
Richter Gedeon	HUF	38,950	49,400	-21.2%	50,200	28.9%

Based on closing prices as of September 10, 2012; Source: Erste Group Research

CEE pharma markets: 1H12 sales sluggish, 2012 outlook rather grim, as healthcare reforms continue to hurt.

The 1H12 results of the CEE-based pharmaceutical companies, with the regional pharma markets delivering rather subdued sales growth, provided more evidence that the home markets are far from safe havens at the moment. The deteriorating macroeconomic environment, with the purchasing power of both patients and institutional state-linked health insurance buyers under pressure, has hampered drug consumption in the CEE region. While demand for pharmaceutical products and services is rather inelastic, the trends speak in favor of cost containment, whenever it is possible. Although generics remain the favored option, they are also subject to ever-mounting pricing pressures, particularly in the Rx segment, with more restrictive regulations coming into effect, limiting the reimbursement in both absolute and relative terms, shortening lists of reimbursed products, introducing more prescription limits for practitioners, and/or shifting products either to specialist prescriptions only or into the OTC area, where the patient has to fully cover expenses for medicines. Achieving savings is an imperative for the ongoing healthcare reforms in the region, and pharmaceuticals are one of the areas most affected by the implemented measures. In addition, the frequently changing regulations bring an additional undesirable element of instability and rather high volatility to the regional pharmaceutical markets. Although pharma companies are in most cases in good financial health, the wholesale and retail partners (particularly in some regional markets, such as Romania) work traditionally with higher financial leverage and, given the worsening access to external financing (including higher interest costs), while payment delays remain chronic, they get squeezed and sometimes even forced out of business.

CEE pharmas performance in CEE markets (1H12)

	Hungary Sales EUR mn	y/y (%)	% of total sales	Poland Sales EUR mn	y/y (%)	% of total sales	Czech Rep. Sales EUR mn	y/y (%)	% of total sales	Romania Sales EUR mn	y/y (%)	% of total sales
Richter Gedeon	58.0	-18.7%	10.3%	41.3	9.5%	7.3%	n.a.	n.a.	n.a.	65.9	0.5%	11.7%
Richter Gedeon*	56.2	-18.8%	11.4%	41.3	9.5%	8.4%	14.8	17.5%	3.0%	16.0	0.0%	3.2%
Egis	51.2	-20.9%	22.1%	28.2	-11.3%	12.2%	9.6	2.1%	4.2%	8.6	0.0%	3.7%
Krka	20.0	-36.9%	3.5%	55.4	-16.9%	9.8%	34.0	6.0%	6.0%	23.2	-1.7%	4.1%

*Source: Erste Group Research, company data, * pharmaceuticals sales only, Egis data recalculated for calendar year*

The CEE producers have no other choice than to try to minimize the negative impact of the persisting pressures; their answers range from product portfolio management (Richter already stopped delivering 11 products to the Hungarian pharma market this year) to optimizing their territorial sales structure (expanding in still quickly developing markets, such as Russia/CIS), as well as operational cost streamlining (cutting headcount in sales and marketing in Hungary, e.g. at Egis and Richter). Krka exploits its innovative edge, with a high share of new products in total sales, helping to defend its above-average margins. Nonetheless, the 2012 interim data confirmed that the initial rather pessimistic 2012 sales guidance provided by Hungarian pharma companies for CEE markets was indeed a true reflection of reality and, in some cases (e.g. Poland), there was even a need for a more negative stance. Fortunately, Russia/CIS remains a bright spot on the map, with the sales growth pace there envisaged to stay in double-digit terms on average in the medium term. In the short term (with a turnaround also depending on the reversal of general macroeconomic conditions), the CEE markets remain under pressure. However, we believe that their long-term catch-up potential in drug consumption is untouched, as all of the major components of growth (ageing populations, increasing public healthcare awareness and progress in bringing innovative medicines to the market, including those addressing poorly treated and/or as yet not adequately diagnosed diseases) remain in place.

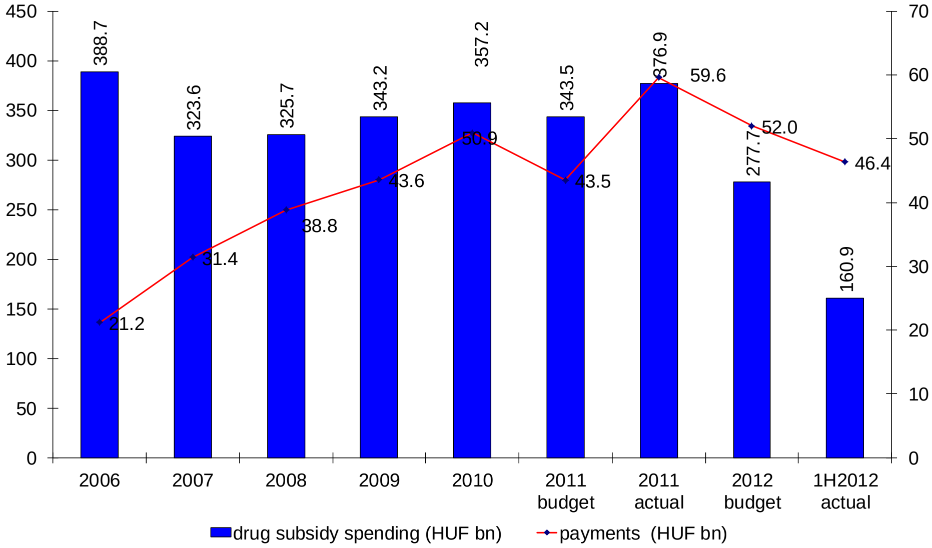
Hungary: Austerity measures send pharma market tumbling.

The Hungarian government plan originally assumed drug reimbursement savings reaching HUF 83bn in 2012 and an additional HUF 37bn in 2013 (i.e. HUF 120bn in total, compared to the 2011 comparative base of HUF 343.5bn). The data for the first six months 2012 shows that, while spending reached HUF 160.9bn (or 58% of the full-year budget of HUF 277.7bn), payments from pharmaceutical manufacturers and wholesalers to the National Health Insurance Fund (OEP) of HUF 46.4bn surpassed the proportional amount of the budgeted sum of HUF 52bn by a wide margin.

The new cost saving measures implemented this year included renegotiation of contracts for subsidy volumes, revision of the subsidy on cholesterol-reducing drugs, cutting the reimbursement on combination drugs, a preferred reference pricing range of 5% above the reference price for active substance reimbursement groups and 10% in the case of therapeutic reimbursement groups (should the price not be kept within the respective range, a 15% reduction of the reimbursement amount will follow), a result-based subsidy system and promoting lower-priced first generics. A maximum one-month Rx dose on a single prescription form is another measure set to affect the market dynamics in 2012. In addition, from April 2012, as a pilot project, the INN prescription system was introduced for cholesterol-lowering drugs statins as the first therapeutic group. Nonetheless, the measure was not implemented in practice, as the possibility of prescribing statins by brand name was again allowed by the subsequent regulation. Also, a new international reference pricing system (with a 20% ceiling above the average of the three cheapest prices of a given manufacturer applied in any of the EU countries to retain reimbursement status) is still waiting to be put into practice.

With the Hungarian government committed to its earlier budget deficit target, keeping it at 2.5% of GDP in 2012 and 2.2% of GDP in 2013, further measures to trim the drug subsidies, on top of the earlier announced amount in the Szell Kalman plan from autumn 2011, are planned. According to the amendment to the healthcare law accepted by the Hungarian Parliament on June 18, 2012, the so-called Spanish Model in the reimbursement system has been introduced in Hungary, affecting original products that have no available generic equivalent, have been on the reimbursement list for at least six years and cost more than HUF 1,000 per package. Manufacturers of these products will have to pay a sales tax equaling 10% of the monthly reimbursement sum to the OEP, on top of the earlier introduced 20% sales tax on reimbursed product sales. The payment is anticipated to bring to the OEP some HUF 850mn in 2012 (assuming payments for the last two months of the year) and rise to HUF 5.8bn to HUF 7.4bn in 2013-14. According to the OEP, 532 medicines will be affected by this regulation in August 2012. However, the number will change over time, as some products will mature to get on the list, while others might leave it. It is estimated that this measure will result in an annual payment liability for Richter of some HUF 100mn.

OEP drug subsidy spending developments



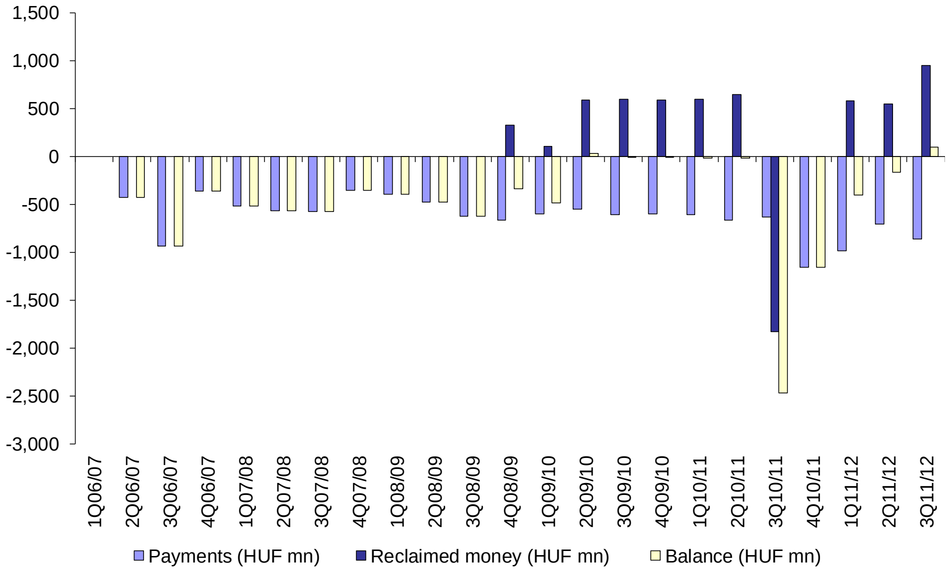
Source: OEP, Erste Group Research

Richter and Egis continue to expect falling top lines in 2012, but time-limited R&D relief should significantly soften the impact of savings measures on the EBIT level.

The interim 2012 results confirmed that the price erosion linked to the new government regulation (which took effect from autumn 2011) has taken a serious bite out of Hungarian pharma market players' top lines, practically erasing the positive effect of the new product launches. Both Richter and Egis saw their Hungarian sales contract in January-June 2012. Blaming in particular the system of 'blind bidding auctions', Egis reported that it was forced to slash prices of its products in Hungary by 6.9% on average from October 2011, the biggest quarterly decrease since April 2007, followed by a 0.6% drop in January and another rather massive 6.75% cut in the next auction round in April 2012. Consequently, CFO Poroszlai became more pessimistic, lowering his original guidance for 2011/12 domestic sales from a drop of 6% to 8% (provided in August 2011) to a fall of 8% to 10% (provided in February 2012 and confirmed in August 2012). The traditionally cautious Richter CEO Bogsch reiterated that he expects Richter's domestic sales to plunge 15% to 20% in 2012 (all guidance in HUF terms). Although until now only Egis has provided guidance beyond 2012, it seems that a further (albeit not as sizable) contraction of their home sales from the currently deeply depressed levels is likely in 2013. Consequently, reflecting Egis' recent guidance, we envisage the 2013 domestic sales of Richter and Egis to slip some 5% y/y, with a gradual pick-up (low single-digit-term growth of around 2.5 - 3% p.a.) to follow in the medium term.

While, unfortunately, details on the additional 2012 and 2013 savings measures are still missing and hence difficult to incorporate into our Richter and Egis forecasts, we want to emphasize that, at least for 2012, there is one positive (albeit temporary) regulatory step in place. The law provides for a 20%-60%-90% extraordinary deduction from the tax for those pharmaceutical companies whose R&D expenditures reached or exceeded 15%-20%-25% of the reimbursement based on the manufacturer price level during 2011. Both Richter and Egis qualify for the maximum allowable R&D-based relief to their OEP payment obligation in 2012. In Richter's case, the law amendment is expected to reduce the net OEP payments to just HUF 0.9bn (hence well below the originally estimated HUF 2bn) in 2012. According to Egis' CFO Poroszlai, the OEP payment related burden is likely to be at some HUF 700mn, also below the previously estimated HUF 1bn in 2011/12, as a consequence of a steeper than originally expected sales fall, as well as the level of reimbursement. One has to bear in mind that, from the accounting perspective, Richter and Egis treat their payment obligation to the OEP differently. While Richter is recording sales rep fees under sales and marketing expenses and sales tax under other operating expenses, in Egis' case, all of the OEP related toll is booked under other operating expenditures. Moreover, while Egis (based on the new law) already started to skip the recording of the OEP related burden in its P&L statements as of 2011/12, Richter continued to register them in the interim 2012 P&L accounts.

Egis' payment to OEP, 1Q06/07-3Q11/12



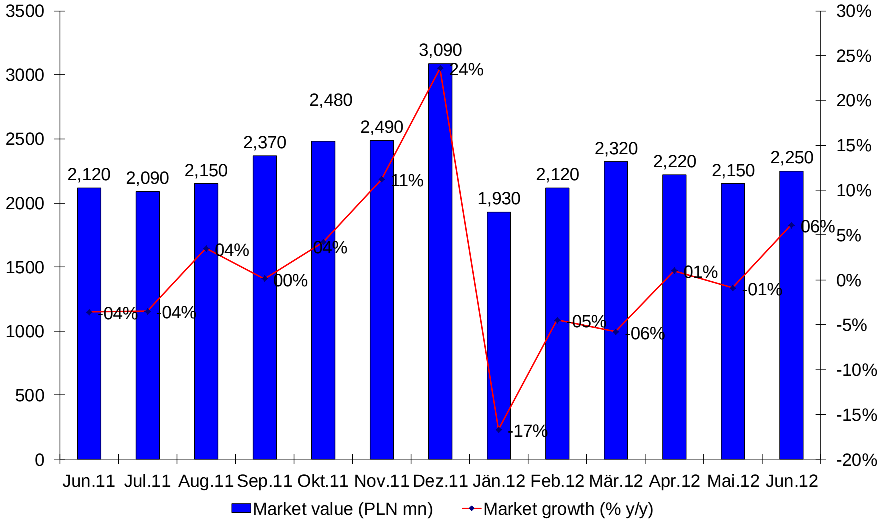
Source: Egis

The Romanian pharmaceutical market keeps expanding, but remains plagued by receivables collection problems.

According to Cegedim, in 1H12, the Romanian pharmaceutical market at wholesale prices advanced in value terms by 12.6% y/y to RON 5.7bn. Sales to hospitals (up 26.5% y/y) were the most dynamic market segment, with the extraordinarily high tempo largely attributable to the regulatory changes, moving certain products in the national health programs from pharmacies to hospitals. OTC product sales also outpaced the overall market, advancing 16.7% y/y to RON 810.2mn in 1H12. While the data looks very positive at first glance, pharma market participants still have numerous reasons for dissatisfaction in doing business in Romania. First of all, payments to the healthcare system from the state budget continue to face chronic delays, with receivables days staying at an astonishingly high 300+ days. While overdue receivables are reportedly not rising, as evidenced by the latest interim reports of CEE-based pharma players, the situation still requires cautious monitoring.

Furthermore, a closer look at the 2012 interim sales of the major CEE players in Romania confirms a rather grim picture at the moment. While Richter and Egis' total consolidated sales in Romania were flat y/y, Krka's sales slipped 1.7% y/y (all in EUR terms). Consequently, the outlook for full-year 2012 is still seen as rather subdued by Richter, the only company providing detailed guidance here, sticking to its forecast of y/y flat pharmaceutical sales in RON terms. After a series of delays, the clawback system (5-11% on sales of reimbursed drugs, depending on turnover) is theoretically in place. Interestingly, referring to the unclear regulatory situation, CEE-based pharma companies continue to treat this obligation differently. While traditionally conservative Richter has started to record clawback payments only from 2Q12 (amounting to RON 3.5mn), Egis already registered an HUF 464mn clawback related provision in its other expenses in 1-3Q11/12. (Based on our information, Krka also paid an undisclosed amount of clawback in 1H12, pushing up its sales & marketing expenses.) A new version of the clawback tax is under discussion and, if approved, it could be valid from 4Q12. Importantly, the value added tax would be excluded from the calculation base of the value of total quarterly consumption of medicines reimbursed by the National Health Insurance House (CNAS) and the budget approved quarterly for the medicines reimbursed by CNAS, while at the same time a reference value of the quarterly sales used for calculations of the clawback value would increase from RON 1.42bn to RON 1.51bn. Furthermore, the new Romanian basic healthcare package is still under preparation, as, after the political unrest, the original proposal was withdrawn. The Romanian health minister emphasized that no persons should be left outside the healthcare system; people on low incomes (and not paying for the compulsory health insurance) will still have access to the social package of medical services. Romanian patients who have a compulsory health insurance policy will have to pay co-payments for certain types of medical services, such as medical consultation, depending on the qualification of the doctor, ranging from RON 4 to RON 7 per consultation; for one day in the hospital, the fee would be RON 20 to RON 60; for an extended hospital stay, RON 40 to RON 80. For laboratory analysis, the co-payment would amount to RON 5 to RON 20. Some proposals speak in favor of removing medicines costing less than RON 10 per package from the reimbursement list. (In 1H12, drugs cheaper than RON 10 constituted 11.4% of the total budget for the drug reimbursement.) Based on the approval of the IMF fund, there is no official deadline for the introduction of the patient co-payment system. However, with the IMF representatives, it was agreed that the new basic healthcare package should go to the Parliament in 4Q12.

Polish pharmacy market sales developments



Source: PharmaExpert

The Polish pharmaceutical market is becoming another troubled hotspot in 2012, hampered by the problematic start of the new reimbursement act in practice. Nonetheless, most producers see the bottom as already being reached, with gradual improvements to take place in 2H12.

There is no doubt that, as the second largest single market after Russia, Poland retains its priority for CEE-based pharma companies. Nonetheless, their interim 2012 results provided compelling evidence of troubles accompanying bringing the new Drug Reimbursement Act into practice. The new legislation took effect on January 1, 2012, but it started to affect the behavior of market participants already in the preceding period, with patients worried by increasing co-payments opting to buy their medicines in advance, pushing up Polish retail pharmacy sales to record levels in December 2011, +24.2% m/m and +23.6% y/y to PLN 3.09bn. Sales of reimbursed medicines climbed 35% y/y. Nonetheless, according to PharmaExpert, already in January 2012, the Polish pharmacy market contracted 16.7% y/y (and 37.6% m/m), with the reason for the slump on the Polish pharma market being not only the previous period's pre-stocking among patients, but also some legislative paragraphs in the Reimbursement Act causing unrest in the medical community, which demanded changes to the legislation. Indeed, the new amendment to the Reimbursement Act was accepted by the Sejm already on January 13, 2012, scrapping strict financial penalties on doctors for incomplete or ill-written prescriptions and granting amnesty to those who issued or accepted such prescriptions since January 1, 2012. Despite the gradual pickup, cumulatively in January-June 2012, Polish pharmacy sales decreased 3.7% y/y, weighed down by a 19.4% y/y slump in Rx product sales. The outlook is far from rosy for 2012. Based on the current trends, including the consequences of the latest update of the list of reimbursed products (taking effect from September, 2012), IMS estimates that the Polish market for reimbursed medicines will shrink 15.5% in value terms and 11.3% in volume terms in 2012. CEE-based pharmas have to prepare for a tough year ahead, as indicated by their latest revised guidance. While Richter projects 5% y/y sales rise in Poland for 2012 (in PLN terms), Egis expects its Polish sales to contract y/y at a faster pace than the overall guidance for CEE markets (envisaging a 10% y/y drop in EUR terms for 2011/12).

Czech Republic pharma market: Still on savings course, dampening sales tempo.

According to IMS Health, in 1Q12, wholesale drug sales in the Czech Republic rose just 1% y/y to CZK 13.3bn, while, in volume terms, they saw a decrease of 6.5% y/y to 70.5mn packages. While the IMS data does not include deliveries made to pharmacies directly by pharmaceutical companies, they provide clear evidence that the cost savings measures of the government (in particular, the revision of reimbursed drug prices), along with the less favorable macroeconomic situation (affecting the purchasing power of patients, decisive for the OTC sales growth), are showing their effect. Furthermore, from July 1, 2012, OTC medicines (those that can be dispensed on prescription) are excluded from the reimbursement list. It is estimated that this step could affect around 400 drugs, with resulting savings for health insurance companies amounting to CZK 1bn per year. While there are still more savings-oriented initiatives on the table (such as increasing the health insurance premium payments for state-insured persons by CZK 49 to CZK 772 per person per month or raising fees for visiting doctors from CZK 30 to CZK 50 as of 2014, payments in full for all dental fillings, etc.), none of the proposals has been approved yet.

CEE pharmas' performance in Russia/CIS (1H12)

	Russia Sales EUR mn	y/y (%)	% of total sales	Ukraine Sales EUR mn	y/y (%)	% of total sales	other CIS Sales EUR mn	y/y (%)	% of total sales	Russia / CIS total Sales EUR mn	y/y (%)	% of total sales
Richter Gedeon	172.9	6.9%	30.7%	30.0	33.3%	5.3%	45.4	39.7%	8.1%	248.3	14.6%	44.2%
Richter Gedeon*	172.9	6.9%	35.0%	29.4	37.4%	5.9%	34.0	24.5%	6.9%	236.3	12.3%	47.8%
Egis	61.2	4.7%	26.4%	8.3	46.2%	3.6%	15.5	19.5%	6.7%	85.0	10.2%	36.7%
Krka	114.9	23.8%	20.3%	27.0	25.6%	4.8%	26.0	28.4%	4.6%	167.9	24.8%	29.7%

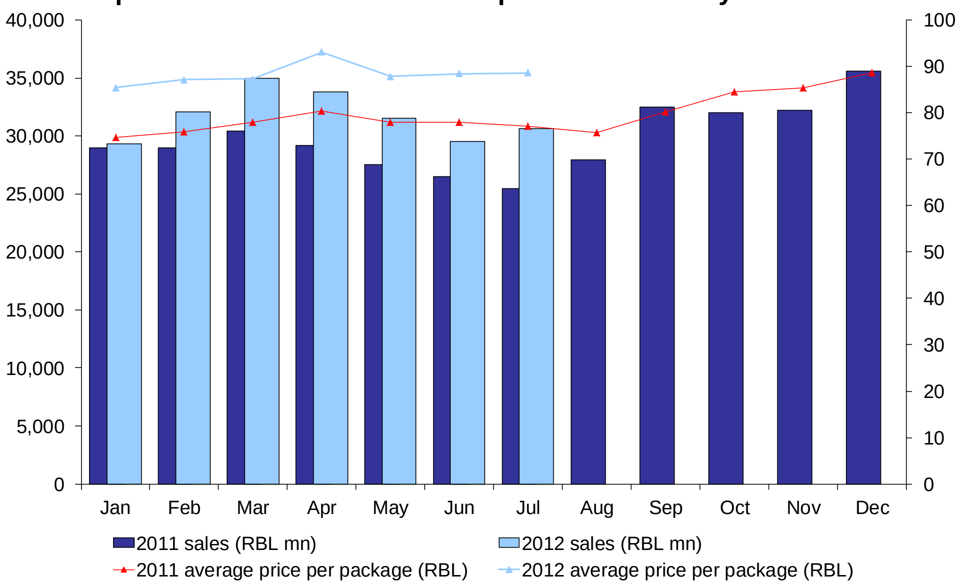
*Source: Erste Group Research, company data, * pharmaceuticals sales only, Egis data recalculated for calendar year*

Russia/CIS: Healthy sales prospects are set to bolster the top line growth of all major CEE pharma players in 2012, offsetting the Central European markets' sluggishness.

With the outlook of CEE home markets darkened by restrictive reform measures, Russia/CIS is shining brighter in the sales reports of the CEE pharma producers, giving support not only to their top line tempo, but also profitability margins this year. A brief look at the 1H12 sales breakdown by territory shows that the share of Russia/CIS in total sales of the top CEE-based pharma producers is well above that of the home country. Moreover, with the growth tempo of Russia/CIS set to outpace other markets, it will undoubtedly expand further. Nonetheless, as in 2011, the quarterly developments in 2012 are marked by relatively high volatility and big discrepancies between the results, however. While the 1H12 tempo was in high double-digit terms for Krka in Russia (and, as it was complemented by an excellent Ukraine and CIS showing, also for the whole Russia/CIS region), the Hungarian peers saw rather moderate sales growth in Russia (6.9% y/y for Richter and 4.7% y/y for Egis), compensated for by the extraordinarily high pace in Ukraine and other CIS markets.

Driven by accelerating prices, the Russian pharma market was up 11.3% y/y in value terms in 1H12.

Russian pharmaceutical market developments in January-June 2012



Source: PharmaExpert

The 2012 Russian pharma market outlook remains bright, a double-digit sales tempo within reach for CEE pharma manufacturers in the medium term.

According to preliminary DSM Group data, in 1H12, the Russian pharmaceutical market advanced 11.3% y/y in ruble terms to RBL 452bn, while the market volume (number of packages sold) rose 2% y/y to 2,836mn packages. The parapharmaceutical market was the most dynamic segment, with sales surging 13.5% y/y to RBL 70.3bn; the commercial pharmaceutical market's growth tempo was only marginally behind, reaching a sound 12.2% y/y rise (to RBL 250.1bn). Detailed information for January-June 2012 shows that the average price of medicines on the commercial market in June 2012 amounted to RBL 88.4 per package, up 13.5% y/y. In 1H12, the share of domestic drugs in the total commercial pharmacy market remained nearly unchanged y/y at 23% in value terms, while (with a 58% share) dominating in volume terms. Based on the data for June 2012, the difference between imported and domestic drug prices remained strikingly high; the domestic medicines' average price per package stood at RBL 33.1(up 16% y/y), vs. the imported drugs' average of RBL 165.6 (up 7.3% y/y). As evidenced by the sales figures reported by CEE pharma companies, as well as overall market statistics provided by the DSM Group, while the measures of the Russian authorities aimed at better price control (particularly of products included on the essential drug list) achieved at least a partial cost saving success, they did not much harm pharmaceutical manufacturers. According to the DSM Group, the prices of medicines on the essential product list since the beginning of the year until the end of June 2012 decreased 0.73%.

CEE pharma manufacturers are well prepared for future regulatory changes in Russia.

The interim 2012 data thus demonstrates that the Russian pharmaceutical market is well on track to meet the forecasts presented by various expert organizations at the beginning of the year. For comparison, the DSM Group's forecast for 2012 envisages that, in the commercial segment, the tempo of the Russian market will be around 12% y/y, while the hospital segment is foreseen to expand by some 5% y/y in value terms. According to the PharmExpert prognosis, in 2012, the commercial segment of the Russian pharmaceutical market is poised to see around a 10% y/y rise, while, together with hospitals and the DLO part, the overall pharmaceutical market pace could reach some 12% y/y (all data in ruble terms). Although, due in part to differences in the comparative base, the performance of the top CEE-based pharma companies in Russia has been uneven on a quarterly basis, with the tempo sliding temporarily below the 10% mark, a double-digit sales tempo in Russia remains a realistic target for the CEE-based pharma producers in the medium term. The latest guidance revisions from the Hungarian companies confirm this view as well. In August 2012, Egis' CFO Poroszlai fine-tuned the 2011/12 targets for Russia and Russia/CIS market sales growth to 5-7% and 6-8%, respectively, but set a new sales growth target at 8-12% y/y for the 2012/13 fiscal year (all guidance in euro terms). Although Richter CEO Bogsch remained optimistic regarding the medium- to long-term outlook for the Russian market, anticipating an average rise of 10% y/y, given the relatively high comparative base (and somewhat higher initial level of inventories, following the exceptionally high 4Q11 sales), he expects a Russian sales rise of up to 5% y/y in ruble terms in 2012. Nevertheless, one has to bear in mind that the original target was a mere 5% y/y rise for 2011 as well, with the company posting 26.2% y/y growth. Finally, we continue to believe that the stable currency developments should also play in favor of a successful business performance for CEE-based exporters to the Russian pharma market, as they have all switched to the ruble as their invoicing currency.

Richter/Egis Russia/CIS sales guidance developments

Richter	actual sales performance		guidance		
y/y sales growth	**1Q2012**	**1H2012**	**Feb-12**	**May-12**	**Aug-12**
Russia/CIS total (EUR terms)	15.7%	12.3%	n.a.	n.a.	n.a.
Russia (RBL terms)	16.2%	6.2%	0 to 5%	0 to 5%	0 to 5%
Ukraine (USD terms)	47.4%	26.2%	5.0%	5.0%	>5%
other CIS markets (USD terms)	-24.1%	14.8%	5.0%	5.0%	5%

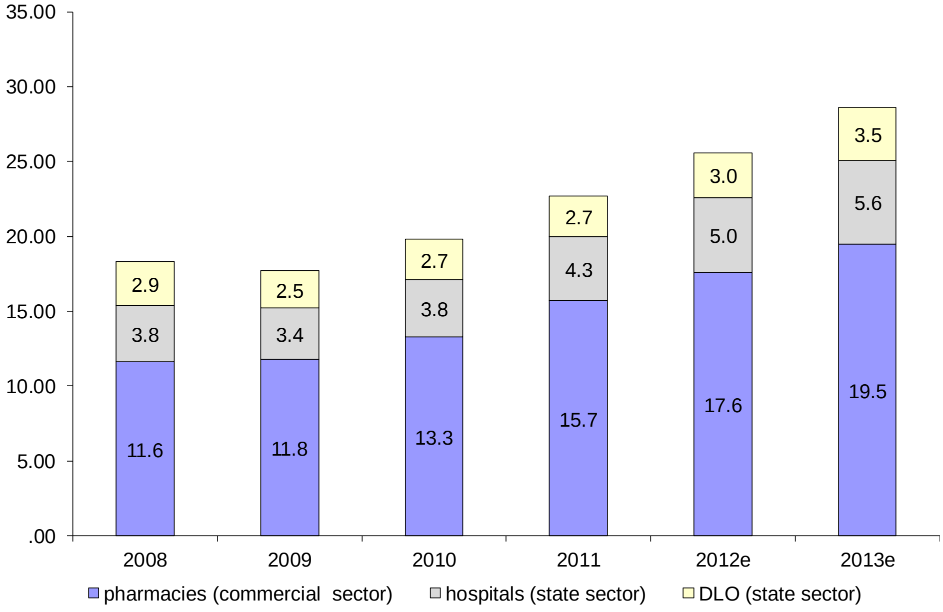
Source: Richter, based on pharmaceutical consolidated sales

Egis	actual sales performance			guidance			
y/y sales growth	**1Q2011/12**	**1H2011/12**	**1-3Q2011/12**	**Nov-11**	**Feb-12**	**May-12**	**Aug-12**
Russia/CIS total (EUR terms)	3.2%	5.6%	8.0%	10 to 12%	10 to12%	5 to 10%	6 to 8%
Russia (EUR terms)	5.3%	4.3%	4.9%	10 to 12%	10 to12%	5 to 10%	5 to 7%

Source: Egis, based on consolidated results

In accordance with the Concept of Long-term Socioeconomic Development of the Russian Federation until 2012, total healthcare expenditures should expand from 3.56% of GDP in 2011 to 5.5% of GDP by 2015 and stabilize at this level afterwards. The pharmaceutical market might see a profound change in 2015 as well, as the Russian government is currently considering the introduction of the obligatory health insurance system based on the Western European model, with Rx medicines then to be reimbursed by the state (unlike the current practice, with state programs for the refunding of drugs restricted to a certain eligible part of the population and limited therapeutic diagnoses). The role of the domestic pharmaceutical industry is envisaged to increase significantly over this time period. The strategy for the Russian pharmaceutical market until 2020 assumes that the share of domestically manufactured drugs will rise from the current 23-24% to 50% (in value terms) by 2020, translating into a significant decrease of Russia's dependence on pharmaceutical imports, while the local manufacturers' portfolios will be modernized and enriched by state-of-the-art products. By 2015, some 57 strategically important drugs (including the newest generation of antibiotics, anesthetics, anti-inflammatory medicines and drugs for the treatment of cancer, hepatitis B and C, cardiovascular diseases, multiple sclerosis, etc.) are planned to be manufactured on the Russian territory. The latest presidential decree even orders the shoring up of the share of domestically manufactured essential products to 90% of the total by 2018. All of this, along with the currently implemented rules (such as a preference for locally manufactured drugs in government tenders, where a 15% discount is required, should the drug winning the tender be manufactured outside Russia), prompts foreign pharma companies to increase their direct manufacturing presence on the Russian territory. While the competition is heating up and many Western-based companies (Teva, GSK, Sanofi, Novo Nordisk, Novatis and Pfizer, among others) have recently started to build up their greenfield investments or enter into joint ventures, the CEE companies still enjoy the first mover advantage in this respect, with Krka and Richter in particular having already established significant local operations. In order to be able to satisfy the increasing local demand, Krka is currently expanding its Russian facility. The investment project (worth EUR 135mn) is scheduled to be finished in 2013. Apart from tableting, the new factory will comprise a logistics center, warehouse and energy facility. After completion, the new factory will increase Krka's Russian local base production output from the current 0.5bn to some 1.5-1.8bn tablets and capsules, supplying more than 50% of Krka's estimated Russian sales. While Krka does not plan API manufacturing in Russia, the products from the new factory might also be channeled to other neighboring markets in the future.

Russian pharma market outlook (market size in USD bn)



Source: PharmExpert

While the appreciation path remains the medium- to long-term scenario, CEE currencies' fortunes have been volatile in 2012.

With all of the top CEE pharma companies being heavily export-oriented and deriving some 75% (Egis) up to around 90% (Krka, Richter) of their total revenues from exports, foreign exchange developments have always played an important role in the final financial performance. The recently increased volatility of the regional currencies magnified the importance of the forex situation on their results further. While for the top line, the average exchange rate represents a good proxy for an estimation of the impact of forex developments in the respective period and the changes are smoothed over time and hence also more predictable, the financial result's final outcome is sometimes subject to very rapid swings, as it is the last day of the period that matters here, when restating relevant balance sheet positions (most importantly receivables and payables, but also financial liabilities, including intra-company loans). The currencies in focus remain the Polish zloty and Russian ruble, followed by other regional currencies such as the Czech crown and Romanian RON, and obviously the euro, the invoicing currency for exports to the EU (Krka, Egis and Richter). The US dollar keeps its relevance mainly for Richter, given its partnerships (Teva, Forest Laboratories) there. On top of that, the PregLem acquisition financing exposed Richter to Swiss franc fluctuations, a new factor affecting its results since 2011. In line with our expectations, reflecting the renewed strength of the US dollar, major CEE currencies (HUF, PLN and CZK) continued to depreciate vs. the US dollar in 1H12, although the pace of weakening vs. the euro was somewhat less steep and some of them (like the Russian ruble and Ukrainian hryvnia) even firmed vs. the euro over the first six months of 2012. The y/y reversing forex fortunes, while benefiting the Hungarian pharmas, weighed on Krka, with its mostly euro-incurred costs and export revenue exposure to the CEE region. Although the CEE currencies entered 2012 on a weaker basis, we continue to think that the trend is envisaged to reverse compared to 2011, with appreciation of major currencies (CZK, PLN, HUF and RON) expected in the second half of the year. Still, with respect to the y/y weaker forint in full-year 2012, both Richter and Egis should see their top lines and profitability get an additional boost, while the relatively unfavorable picture is set to dampen Krka's results.

CEE currencies vs. USD, EUR in 1H12

	1H11 average USD	1H12 average USD	1H12 y/y USD	1H11 average EUR	1H12 average EUR	1H12 y/y EUR
Hungarian forint	192.2	227.84	-15.7%	269.4	295.5	-8.8%
Czech crown	17.4	19.4	-10.6%	24.3	25.2	-3.3%
Polish zloty	2.8	3.3	-13.9%	4.0	4.2	-6.9%
Romanian leu	3.0	3.4	-11.9%	4.2	4.4	-4.8%
Russian rouble	28.6	30.6	-6.6%	40.2	39.7	1.1%
Ukrainian hryvnia	8.0	8.0	-0.4%	11.2	10.4	7.7%

	2Q11 average USD	2Q12 average USD	2Q12 y/y USD	2Q11 average EUR	2Q12 average EUR	2Q12 y/y EUR
Hungarian forint	184.9	229.49	-19.4%	266.3	294.3	-9.5%
Czech crown	16.9	19.7	-14.3%	24.3	25.3	-3.7%
Polish zloty	2.7	3.3	-17.2%	4.0	4.3	-7.0%
Romanian leu	2.9	3.5	-16.8%	4.1	4.4	-6.6%
Russian rouble	28.0	31.0	-9.7%	40.3	39.8	1.2%
Ukrainian hryvnia	8.0	8.0	-0.2%	11.5	10.3	11.8%

Source: Erste Group Research, national banks' statistics

Changes in government bond yields, equity market risk premiums, prompt us to adjust our DCF-based valuation models.

Since the publication of our last CEE pharma sector report in March 2012, interest rates in major world economies have stayed at their historically low levels (the US Federal Reserve keeps the key interest rate at the unprecedented range of zero to 0.25%). In the Eurozone, interest rates are anticipated to remain low in the coming quarters (with the European Central Bank's interest rate to be possibly cut from the current 0.75% to 0.5%). While in the CEE region the picture is mixed at the moment, in most of the markets (like in Hungary, the Czech Republic, Poland), downward corrections of rates are expected to come sooner or later. Nonetheless, the external indebtedness of CEE pharma companies continues to be minimal (with some of them, like Egis, sitting on a heavy cash pile). And as the investment plans of the regional pharma companies do not rely on extensive tapping of financial markets, the current credit market conditions have not been of significant importance for their financial results. Thus, the main factors we have to reconsider in our models are the applied equity risk premiums and risk-free rates, as well as changing currency forecasts.

Our methodology for setting equity risk premiums (linked to the respective country's S&P long-term foreign currency rating) that we introduced in our pharma sector report in May 2009 remains unchanged. In summary: 4.5% is used as a base equity risk premium (mirroring the long-term outperformance of stocks vs. bonds), 25bp is added for each rating notch below AAA and 40bp is added for each rating notch below investment grade (i.e. below BBB-). For perpetuity, extra charges are trimmed to 20bp and 35bp, respectively (while still based on the current rating). Since our last report, some European countries saw their ratings cut by major rating agencies, including S&P. Most importantly, Slovenia saw another downgrade to A in August 2012 (while in March 2012 its rating stood at A+). After Hungary's status was cut to junk in January 2012, its rating by S&P did not see any change since our last sector report in March 2012, staying at BB+. As before, the application of the methodology keeps punishing the two Hungarian pharma companies, with the resulting equity risk premium well above other regional peers', particularly that of Krka. Nevertheless, with the Hungarian macroeconomic picture seen stabilizing somewhat and talks with the IMF/EU approaching, Hungarian government bond yields embarked on a descending path recently. Consequently, in our Richter and Egis DCF models, while maintaining our conservative stance, reflecting the recent developments, we decrease the risk-free rate from 8.6% (applied in March

2012) to 7.5%. At the same time, we increase the risk rate for Slovenia from 5.5% to 6.6%. For Romania, we decided to make an downward adjustment from 7.0% to 6.8% and for Poland a downward fine-tuning from 5.8% to 5.1%.

1H12 results review

Antibiotice: Antibiotice announced its 1H12 results on August 10, 2012. In 1H12, Antibiotice's sales growth was at a solid 7.3% y/y to RON 148.65mn, slightly above our more pessimistic expectations. The main reason for the sales exceeding our estimate was the more robust exports (in particular, the strong showing in the US market), further bolstered by the RON depreciation. Operating profit surged 44.2% y/y to RON 36.5mn, translating into an EBIT margin of 24.6%, up 6.3pp y/y, mainly as a result of the boost from the reversal of receivables write-offs (RON 6.05mn). On the other hand, the RON weakening resulted in forex losses, weighing on the financial result, sending it into red territory (to a loss of RON 6.8mn vs. the year-earlier financial profit of RON 2.9mn). Nonetheless, net profit still increased 11.3% y/y to RON 25.75mn.

Biofarm: Biofarm published its 1H12 report on August 16, 2012. The company's sales advanced 7.0% y/y to RON 52.9mn. Although, similarly to its peer Antibiotice, Biofarm had to cope with the negative impact of the weakening RON on raw material expenses and face the fierce competition in the company's core OTC market, its EBIT expanded 20.0% y/y to RON 15.3mn and net profit rose 11.5% y/y to RON 12.3mn in 1H12, ending well above our conservative estimates. Although the steep y/y progress was partly attributable to a reversal of provisioning, the adjusted operating profit was still 15.4% higher y/y.

Bioton: Bioton published its 1H12 results on August 31, 2012. The 1H12 picture was dominated by huge one-off items (milestone payments from Actavis linked to signing a strategic cooperation deal), pushing up the top line, bolstering the operating level and, most importantly, lifting the bottom line out of the red. Consequently, in 1H12, sales climbed 71.1% y/y to PLN 230.5mn and Bioton reported an operating profit of PLN 63.3mn. Further bolstered by the forex gain-driven y/y turnaround in the financial result, combined with a gain on discontinued operations, the company posted net profit after minorities of PLN 66.2mn (vs. the year-earlier net loss of PLN 34.3mn; all data consolidated according to IFRS standards).

Egis: Egis published its 3Q11/12 report on August 6, 2012. The mounting pricing pressures associated in particular with 'blind bidding' auctions dragged Egis' domestic sales down 17.5% y/y in the April-June 2012 period. Nonetheless, reflecting the healthy Russia/CIS performance, the export picture was more optimistic, with exports advancing 5.9% y/y to EUR 91.6mn. In summary, helped by the tailwind from the y/y weakening forint, Egis' 3Q11/12 sales rose 7.1% y/y to HUF 34,669mn. The improving sales mix and positive currency developments were only partly compromised by price erosion at home and the gross profitability margin improved y/y (to 59.3%) in 3Q11/12. Furthermore, while in the year-earlier period the company's operating result was burdened by the cumulative effects of the renewed home market regulatory toll, in 3Q11/12, Egis enjoyed the newly available possibility of R&D-based relief. Consequently, operating profit jumped 88.1% y/y to HUF 5,939mn in 3Q11/12. Reflecting the end of the quarter less favorable currency fortunes, the 3Q11/12 financial result sunk into red territory, but nonetheless improved significantly y/y. Bolstered further by the y/y decreasing effective tax rate, 3Q11/12 net profit skyrocketed (up 121.2% y/y to HUF 5,110mn).

Krka: Publishing its 1H12 results on July 26, 2012, Krka kicked off the reporting season in the CEE pharma universe. In 1H12, Krka's consolidated sales advanced 6.9% y/y to EUR 565.3mn, as the y/y pickup in Russia/CIS, complemented by the strong performance in Western European markets, counterbalanced the sluggish CEE sales (dragged down by the underperforming but crucial Polish market). Reflecting the ongoing pricing pressures, in particular in the CEE region, where they were coupled with less favorable currency developments, Krka's gross margin worsened y/y to 61.1% in 1H12 (from 62.2% in 1H11). Furthermore, although the company managed to cut its administrative costs 5.4% y/y, both its R&D expenses as well as accelerating sales and marketing costs outpaced the sales tempo, sending operating profit down 5% y/y (to EUR 117.1mn) in 1H12. Weighed down by the q/q deteriorating forex situation along with new impairments and write-offs of receivables, the financial result dived deeper into red territory than in 1H11. Nonetheless, as the effective tax rate decreased y/y, the 1H12 net profit drop was minimized to 2.6% y/y.

Richter Gedeon: Richter announced its 2Q12 results on August 2, 2012. As the subdued domestic sales (down 14% y/y) were more than offset by expanding exports, buoyed by the y/y significantly weaker forint, Richter's 2Q12 top line advanced 11.9% y/y to HUF 84,012mn. The positive impact of the y/y increasing share of high-margin Russia/CIS sales and more favorable forex situation were somewhat compromised by the y/y slump in the US sales revenues, rising sales of the wholesale/retail segment as well as amortization charges linked to the Esmya launch. Consequently, the gross profitability margin slightly worsened y/y (to still sound 62.9%, from 63.1% in 2Q11). Hampered by y/y surging sales & marketing as well as R&D expenses, operating profit slid 0.2% y/y to HUF 13,130mn. With the year-earlier period hurt by huge forex losses, the comparative 2Q net profit level was relatively easy to surpass this time. While the forint firming at the end of the quarter negatively affected the revaluation of receivables/payables and the financial result ended in red numbers, the loss was significantly less sizable y/y. Net profit went up a robust 33.7% y/y to HUF 11,367mn in 2Q12.

1H12 CEE Pharma performance at a glance

Antibiotice

RAS	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Total sales (RON mn)	76.64	67.33	*13.8%*	148.65	138.53	*7.3%*
Operating profit (RON mn)	18.56	12.20	*52.1%*	36.50	25.31	*44.2%*
Net income (RON mn)	12.77	9.87	*29.4%*	25.75	23.14	*11.3%*
Operating margin	*24.2%*	*18.1%*		*24.6%*	*18.3%*	
Net margin	*16.7%*	*14.7%*		*17.3%*	*16.7%*	

Biofarm

RAS	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Total sales (RON mn)	25.66	20.90	*22.8%*	52.92	49.48	*7.0%*
Operating profit (RON mn)	7.37	4.32	*70.5%*	15.32	12.76	*20.0%*
Net income (RON mn)	5.60	5.00	*12.1%*	12.28	11.01	*11.5%*
Operating margin	*28.7%*	*20.7%*		*28.9%*	*25.8%*	
Net margin	*21.8%*	*23.9%*		*23.2%*	*22.3%*	

Bioton

IFRS consolidated	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Total sales (PLN 000)	69,025	80,335	*-14.1%*	230,509	134,706	*71.1%*
Operating profit (PLN 000)	-16,319	-12,213	*33.6%*	63,254	-26,817	*n.m.*
Net income (PLN 000)	13,735	-18,123	*n.m.*	66,179	-34,323	*n.m.*
Operating margin	*-23.6%*	*-15.2%*		*27.4%*	*-19.9%*	
Net margin	*19.9%*	*-22.6%*		*28.7%*	*-25.5%*	

Egis

IFRS consolidated	3Q11/12	3Q10/11	y/y	1-3Q11/12	1-3Q10/11	y/y
Net sales (HUF mn)	34,669	32,377	*7.1%*	98,570	95,866	*2.8%*
Operating profit (HUF mn)	5,939	3,158	*88.1%*	18,336	14,283	*28.4%*
Net income (HUF mn)	5,110	2,310	*121.2%*	16,895	11,525	*46.6%*
Operating margin	*17.1%*	*9.8%*		*18.6%*	*14.9%*	
Net margin	*14.7%*	*7.1%*		*17.1%*	*12.0%*	

Krka

IFRS consolidated	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Total sales (EUR 000)	291,746	270,849	*7.7%*	565,292	528,805	*6.9%*
Operating profit (EUR 000)	62,298	62,357	*-0.1%*	117,055	123,247	*-5.0%*
Net income (EUR 000)	41,425	44,480	*-6.9%*	90,066	92,441	*-2.6%*
Operating margin	*21.4%*	*23.0%*		*20.7%*	*23.3%*	
Net margin	*14.2%*	*16.4%*		*15.9%*	*17.5%*	

Richter

IFRS consolidated	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Total sales (HUF mn)	84,012	75,068	*11.9%*	166,018	145,907	*13.8%*
Operating profit (HUF mn)	13,130	13,162	*-0.2%*	28,485	23,390	*21.8%*
Net income (HUF mn)	11,367	8,500	*33.7%*	28,119	19,675	*42.9%*
Operating margin	*15.6%*	*17.5%*		*17.2%*	*16.0%*	
Net margin	*13.5%*	*11.3%*		*16.9%*	*13.5%*	

Source: Erste Group Research

2012 CEE Pharma guidance at a glance

Company	Sales	Sales growth (y/y)	EBIT	EBIT growth (y/y %)	Net profit	Net profit growth (y/y %)
Antibiotice	RON 307.2mn	9% in RON terms	n.a.	n.a.	n.a.	n.a.
Biofarm	around RON 100mn	7 to 8% in RON terms	n.a.	n.a.	RON >20mn	> 37.7%
Bioton	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Egis	HUF 132.8bn to HUF 135.4bn	3 to 5% in HUF terms	n.a.	n.a.	n.a.	n.a.
Krka	EUR 1,134mn	6.0%	n.a.	n.a.	EUR 170mn	4.4%
Richter Gedeon	EUR 1,099.5mn	0% in EUR terms	EBIT margin of 15 to 16%	n.a.	n.a.	n.a.

Source: Company data, target sales figures of Antibiotice, Biofarm, Richter and Egis recalculated based on guidance for y/y growth

2012 CEE Pharma Erste Group Research forecasts at a glance

Company	Sales	y/y %	EBIT	y/y %	Net profit	y/y %	Comment
Antibiotice	RON 307.8mn	9.2%	RON 33.1mn	3.1%	RON 21.0mn	4.5%	Given the more detrimental than originally assumed impact of the home regulatory toll and the deterioration of domestic sales, the y/y progress will be limited.
Biofarm	RON 100.4mn	7.4%	RON 20.9mn	30.0%	RON 19.3mn	32.9%	With its significantly lower exposure to the Rx segment as well as better financial position coupled with strong cost control, Biofarm is poised to outpace Antibiotice this year.
Bioton	PLN 392.5mn	35.8%	PLN 48.1mn	n.m.	PLN 50.9mn	n.m.	The 2012 results are to be boosted by the Actavis deal related milestone of EUR 22.25mn.
Egis	HUF 132,968mn	3.1%	HUF 21,211mn	30.1%	HUF 18,675mn	37.5%	The relative weakness of the forint continues to play a major role in the final outcome, with an HUF 1 weakening lifting the operating line by some HUF 100mn.
Krka	EUR 1,146mn	6.5%	EUR 234.5mn	9.6%	EUR 175.0mn	7.5%	Krka is the strongest beneficiary of the potential appreciation of CEE currencies in the course of 2H12.
Richter	HUF 325,628mn	5.8%	HUF 52,868mn	-13.2%	HUF 51,333mn	4.0%	The possible milestone payment from Forest Laboratories, linked to the US regulatory filing before the year-end,represents an upside to our forecast

Source: Erste Group Research

2012 CEE Pharma reporting calendar

Date	Company	Release / event
14.11.2012	Egis	4Q2011/12 results
14.11.2012	Biofarm	1-3Q2012 results
14.11.2012	Bioton	3Q2012 results
15.11.2012	Antibiotice	1-3Q2012 results
15.11.2012	Krka	1-3Q2012 results
1. or 2. week of November	Richter Gedeon	3Q2012 results

Source: Erste Group Research, company data

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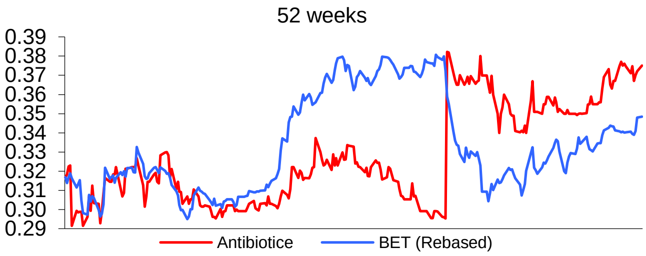
ERSTE GROUP

Antibiotice

from Hold to Reduce

RON mn	2011	2012e	2013e	2014e
Net sales	281.9	307.8	336.4	360.1
EBITDA	48.8	52.6	55.8	61.3
EBIT	32.1	33.1	35.7	39.2
Net result after min.	20.1	21.0	24.2	27.4
EPS (RON)	0.04	0.04	0.04	0.05
CEPS (RON)	0.07	0.07	0.08	0.09
BVPS (RON)	0.50	0.53	0.55	0.58
Div./share (RON)	0.02	0.01	0.02	0.02
EV/EBITDA (x)	5.1	5.5	5.3	4.8
P/E (x)	8.5	10.2	8.8	7.8
P/CE (x)	4.5	5.2	4.7	4.4
Dividend Yield	5.1%	3.9%	4.5%	5.1%



Performance	12M	6M	3M	1M
in RON	15.0%	12.5%	4.2%	5.6%

Share price (RON) close as of 10/09/2012	0.3750
Number of shares (mn)	568.0
Market capitalization (RON mn / EUR mn)	213 / 48
Enterprise value (RON mn / EUR mn)	290 / 65

Reuters	ATBE.BX	Free float	37.0%
Bloomberg	ATB RO	Shareholders	Ministry of Health (53.0%)
Div. Ex-date	11/05/12		SIF Oltenia (10%)
Target price	**0.3550**	Homepage:	www.antibiotice.ro

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Clawback to really bite into profits

We downgrade the stock to Reduce (from Hold) and cut our target price to RON 0.355, reflecting the more detrimental than previously envisaged impact of the clawback tax, a serious deceleration of domestic sales offsetting the boost from higher exports and the weak quality of receivables.

After a nice mid-year picture, 2H12 and especially 4Q are likely to bring a negative development, given that the company postponed the registration of 1Q12 clawback expenses for the last quarter. The clawback tax, estimated at about EUR 4mn per year, will take its toll starting from 2012 onwards, with this higher than initially envisaged amount triggering an average 2.5pp decrease in the EBIT margin over the detailed forecast period.

The boost in exports (+33% y/y in 1H12), likely to continue in the second part of 2012, will be offset by a significant deceleration of domestic sales, depressed by the ambiguous clawback regulation and delayed payments in the public healthcare sector.

Further receivables write-offs are likely, due to poor payment discipline in the pharma sector, with receivables on the Rx segment collected in over 300 days. This will keep ST indebtedness (for working capital financing) under further pressure. Additionally, the company has to find the resources to pay RON 8.6mn in cash dividends for FY11, as the majority shareholder, the MoH, did not agree with dividend capitalization (i.e. in the previous years, dividends have been capitalized). Not least, CAPEX needs to remain elevated in order for the company to capitalize on market opportunities.

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1H12 results review

Boosting exports supportive of operating performance

Thanks to a 33.5% jump in exports, boosted by sales in Russia/CIS and even Africa, 1H12 net sales came in 7.3% higher y/y at RON 148mn, a positive surprise, given the modest 1.1% advance in the first quarter and mounting pessimism on the domestic market over the second quarter. The clawback tax is blamed for the poor performance of the domestic pharma market in 2Q12, with manufacturers 'forced' to focus on profitability rather than on expanding sales. Thus, the market advance decelerated to only 4.4% y/y (RON terms) in 2Q12, from roughly 22% in 1Q12.

RAS	2Q12	2Q11	y/y	1H12	1H11	y/y
Net sales (RON mn)	76.64	67.33	13.8%	148.65	138.53	7.3%
Operating profit (RON mn)	18.56	12.20	52.1%	36.50	25.31	44.2%
Adj. operating profit (RON mn)	12.12	12.58	-3.6%	30.45	27.08	12.4%
Net profit (RON mn)	12.77	9.87	29.4%	25.75	23.14	11.3%
OperatIng margin	*24%*	*18%*		*25%*	*18%*	
Net margin	*17%*	*15%*		*17%*	*17%*	

Source: Antibiotice Iasi, Erste Group Research

Receivables write-offs/write-off reversals systematically impacted operating performance

Operating profit came in 44% higher y/y, with a strong boost from the reversal of receivables write-offs. Net profit advanced 11% y/y in 1H12. An FX loss (RON 5.6mn) was responsible for the financial result, taking its toll on the net result.

Changes in forecast/outlook

We cut our forecasts, given the rather gloomy outlook of domestic sales overshadowing the nice jump in exports, as well as due to the more detrimental than previously envisaged impact of the clawback tax on profit.

RAS	2012e			2013e		
(RON, mn)	Now	Before	Change	Now	Before	Change
Sales	307.8	315.6	-2%	336.4	345.3	-3%
EBITDA	52.6	54.6	-4%	55.8	57.9	-4%
EBIT	33.1	36.3	-9%	35.7	37.8	-6%
Net profit	21.0	24.0	-13%	24.2	27.1	-11%

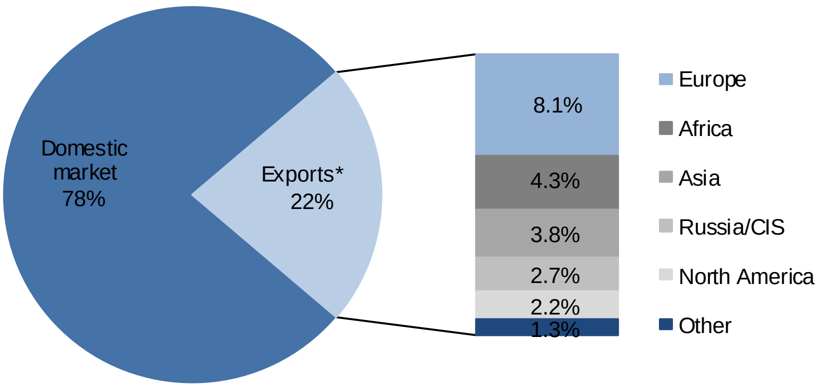
Source: Erste Group Research

We expect net sales to amount to RON 307.8mn (9.2% y/y) this year, on the back of a 34% y/y advance in exports and a 3% increase in sales on the domestic market.

Exports remain driver of company's business

The company managed to tap new foreign markets (in South America, Africa and the Middle East) with its main product, the active substance Nystatin, and to consolidate sales with its existing partners (especially Russia/CIS). With regard to the finished products, the contract for the US market has been renegotiated, and deliveries under the new terms will start in September. Although the contract value has been downsized to USD 3mn, the good news is that the hindrances incurred, which have so far made the partnership non-functional, have been overcome. Also, the company managed to authorize its first finished product on the Canadian market (more to follow), with procedures for starting deliveries on this market in the final tuning stage. European countries will remain, however, the main foreign markets for the company, with a weight in exports of around 35%. Given the above, we are confident that Antibiotice will end 2012 with a significant jump in exports, while for the next couple of years, an annual average growth rate of 7% is a reachable target.

Sales breakdown (1H12)



Source: Antibiotice Iasi, Erste Group Research
**) Last available data (2011)*

Domestic sales to decelerate, in line with market

Domestic sales should decelerate, in line with market trends, with manufacturers discouraged by the clawback tax, which will also take a toll on company profits (i.e. tax charged on the difference between the quarterly reimbursed drugs value and a reference value set by the National Health Insurance House; according to the industry, this tax accounts for more than 30% of Rx drugs sold).

Clawback tax to take toll on profit starting this year

Based on our discussion with the company, the quarterly charge is estimated at around EUR 1mn (~RON 4.5mn). More problematic is the fact that, due to a lack of relevant information, the company postponed the registration of 1Q12 clawback expenses for the last quarter of the year. Thus, after the nice mid-year picture, the outlook for the second half of 2012 is quite bleak. Starting in October, a lower tax level will be applied; however, considering that Romania assumed, in its negotiations with the IMF, to cash in a consistent amount in clawback tax, we prefer to be conservative and assume in our forecast scenario a tax expense of EUR 1mn quarterly, in line with company guidance.

The proceeds from this tax are aimed at reducing arrears in the healthcare sector and shortening the payment terms, and thus the net outcome for the industry is not that bad. However, the effective positive impact, reflected in improved payment discipline and a lowered reliance on bank ST debt for working capital financing, at least in Antibiotice's case, is unlikely to be seen earlier than in two to three years.

Poor payment discipline in sector, with receivables collected in more than 300 days still current issue

The high receivables collection period will remain an issue for the company and a subject for further write-offs. Given the very long payment terms on the domestic pharma market (over 300 days), the company is in the position of recording write-offs for overdue receivables, which are subsequently (if the client pays) reversed. Due to this peculiarity of the Romanian market, we see it as more relevant to work with the adjusted EBIT, which in 1H12 was 12% higher y/y and some 4.3% above our forecast. In 2Q, the company recorded the clawback tax, expected to amount on average to

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about EUR 1mn per quarter; this heavily weighed on 2Q12 adjusted operating profit, which was 3.6% lower y/y (7.6% above our forecast).

Marketing expenses (for which we also consider commercial discounts) remain elevated at over 20% of gross sales, prompted by fierce competition. Although management strives to find ways to mitigate the pressure on marketing expenses, we see potential savings on this side as the least likely.

Following the changed assumption of our forecast scenario, we lowered our EBIT and net profit estimates by 9% and 13%, respectively, to RON 33.1mn (+3 y/y) and RON 21mn (+4.5% y/y).

Further reliance on ST loans to finance working capital needs

As a result of including in our model a higher than previously envisaged expense because of the clawback tax, the EBIT margin is lowered on average by 2.5pp. The company is exposed to FX risk, with LC depreciation against the EUR and USD leading to financial loss. This mainly stems from the revaluation of loans in FC, otherwise the amounts in FC received for exports match in a large extent payments for imported raw materials.

We see it as unlikely that the payment discipline in the sector will significantly improve in the next two to three years, and for this reason we expect further pressure on ST indebtedness. Moreover, the majority shareholder, the Ministry of Health, did not agree with the capitalization of last year’s dividends; thus, the company has to pay RON 8.6mn in cash dividends, which puts additional pressure on the already stretched cash flow. We do not see the debt/equity ratio falling below 50% in the coming two years.

Recommendation and target price

Rating cut to Reduce, target price RON 0.355

We downgrade the stock to Reduce (from Hold) and cut our target price to RON 0.355, reflecting the more detrimental than previously envisaged impact of the clawback tax, a serious deceleration of domestic sales offsetting the boost from higher exports and the weak quality of receivables.

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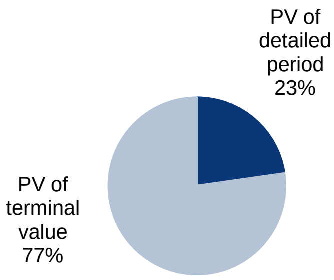
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	6.8%	6.8%	6.8%	6.8%	6.8%	5.0%
Equity risk premium	7.2%	7.2%	7.2%	7.2%	7.2%	6.7%
Beta	1.1	1.1	1.1	1.1	1.1	1.0
Cost of equity	**14.7%**	**14.7%**	**14.7%**	**14.7%**	**14.7%**	**11.7%**
Cost of debt	10.3%	10.3%	10.3%	10.3%	10.3%	8.5%
Effective tax rate	18.0%	18.0%	18.0%	18.0%	18.0%	17.0%
After-tax cost of debt	**8.4%**	**8.4%**	**8.4%**	**8.4%**	**8.4%**	**7.1%**
Equity weight	65%	65%	65%	65%	65%	80%
WACC	**12.5%**	**12.5%**	**12.5%**	**12.5%**	**12.5%**	**10.7%**

DCF valuation

(RON mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Sales growth	*9.3%*	*7.0%*	*5.9%*	*5.9%*	*6.6%*	*4.5%*
EBIT	35.7	39.2	42.0	43.4	45.7	49.9
EBIT margin	*10.4%*	*10.7%*	*10.9%*	*10.5%*	*10.5%*	*11.0%*
Tax rate	*18.0%*	*18.0%*	*18.0%*	*18.0%*	*18.0%*	*17.0%*
Taxes on EBIT	-6.4	-7.1	-7.6	-7.8	-8.2	-8.5
NOPLAT	**29.2**	**32.1**	**34.5**	**35.6**	**37.5**	**41.4**
+ Depreciation	20.1	22.1	22.1	22.1	22.1	24.0
Capital expenditures / Depreciation	*102.0%*	*101.8%*	*115.4%*	*119.9%*	*131.2%*	*100.0%*
+/- Change in working capital	-17.0	-12.8	-10.7	-16.5	-12.2	-9.8
Chg. working capital / chg. Sales	*-52.9%*	*-55.7%*	*-61.0%*	*-57.8%*	*-57.7%*	*-50.0%*
- Capital expenditures	-20.5	-22.5	-25.5	-26.5	-29.0	-24.0
Free cash flow to the firm	**11.9**	**18.9**	**20.4**	**14.7**	**18.5**	**31.7**
Terminal value growth						*2.0%*
Terminal value						369.9
Discounted free cash flow - Dec 31 2012	10.6	15.0	14.3	9.2	10.2	201.4
Enterprise value - Dec 31 2012	**260.6**					
Minorities	0.0					
Non-operating assets	0.0					
Net debt	77.4					
Other adjustments	0.0					
Equity value - Dec 31 2012	**183.3**					
Number of shares outstanding (mn)	568.0					
Cost of equity	14.7%					
12M target price per share (RON)	**0.355**					
Current share price (RON)	0.375					
Up/Downside	*-5.2%*					

Enterprise value breakdown



Sensitivity (per share)

WACC	Terminal value EBIT margin 10.0%	10.5%	11%	11.5%	12.0%
9.7%	0.354	0.380	0.406	0.432	0.458
10.2%	0.330	0.355	0.379	0.404	0.428
10.7%	0.309	0.332	**0.355**	0.379	0.402
11.2%	0.290	0.312	0.334	0.356	0.378
11.7%	0.274	0.294	0.315	0.336	0.357

WACC	Terminal value growth 1.0%	1.5%	2.0%	2.5%	3.0%
9.7%	0.355	0.379	0.406	0.436	0.472
10.2%	0.334	0.355	0.379	0.406	0.436
10.7%	0.315	0.334	**0.355**	0.379	0.406
11.2%	0.298	0.315	0.334	0.355	0.379
11.7%	0.283	0.298	0.315	0.334	0.355

Source: Erste Group Research

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Income Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(RAS, RON mn, 31/12)	31/12/2009	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014
Net sales	**219.75**	**243.63**	**281.86**	**307.85**	**336.43**	**360.11**
Invent. changes + capitalized costs	-2.22	2.58	1.45	4.30	7.79	7.08
Total revenues	**217.53**	**246.21**	**283.31**	**312.15**	**344.23**	**367.19**
Other operating revenues	1.21	2.32	1.17	0.76	0.83	1.08
Material costs	-61.24	-76.02	-95.22	-104.51	-113.26	-121.23
Personnel costs	-63.42	-65.44	-68.43	-68.96	-68.95	-67.97
Other operating expenses	-54.30	-63.33	-72.08	-86.85	-107.09	-117.79
EBITDA	**39.78**	**43.74**	**48.75**	**52.58**	**55.76**	**61.28**
Depreciation/amortization	-13.61	-13.18	-16.67	-19.49	-20.10	-22.10
EBIT	**26.17**	**30.56**	**32.08**	**33.08**	**35.66**	**39.18**
Financial result	-10.53	-12.09	-5.67	-7.50	-6.13	-5.82
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**15.65**	**18.47**	**26.41**	**25.59**	**29.53**	**33.37**
Income taxes	-3.73	-5.93	-6.34	-4.61	-5.32	-6.01
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	0.00	0.00	0.00	0.00	0.00	0.00
Net result after minorities	**11.92**	**12.54**	**20.07**	**20.98**	**24.22**	**27.36**

Balance Sheet	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(RAS, RON mn, 31/12)						
Intangible assets	1.81	1.99	1.65	4.73	5.18	5.73
Tangible assets	156.83	166.41	173.69	168.58	168.49	168.39
Financial assets	0.08	0.08	0.02	0.08	0.08	0.08
Total fixed assets	**158.72**	**168.48**	**175.36**	**173.40**	**173.75**	**174.20**
Inventories	34.15	40.41	41.93	46.39	47.93	49.33
Receivables and other current assets	179.77	179.81	224.84	227.72	248.87	264.41
Other assets	0.48	0.33	0.30	0.35	0.37	0.34
Cash and cash equivalents	3.58	3.72	5.34	7.61	2.36	11.27
Total current assets	**217.98**	**224.27**	**272.41**	**282.07**	**299.53**	**325.35**
TOTAL ASSETS	**376.70**	**392.75**	**447.77**	**455.47**	**473.28**	**499.55**
Shareholders'equity	**242.02**	**262.61**	**286.83**	**299.42**	**313.95**	**330.37**
Minorities	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
LT provisions	**14.01**	**13.90**	**14.59**	**15.00**	**16.00**	**15.00**
Interest-bearing LT debts	0.00	0.00	0.00	0.00	0.00	0.00
Other LT liabilities	0.03	0.00	0.00	0.10	0.10	0.10
Total long-term liabilities	**0.03**	**0.00**	**0.00**	**0.10**	**0.10**	**0.10**
Interest-bearing ST debts	74.75	69.30	82.42	85.00	83.00	90.00
Other ST liabilities	45.89	46.93	63.93	55.95	60.23	64.08
Total short-term liabilities	**120.63**	**116.23**	**146.35**	**140.95**	**143.23**	**154.08**
TOTAL LIAB. , EQUITY	**376.70**	**392.75**	**447.77**	**455.47**	**473.28**	**499.55**

Cash Flow Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(RAS,RON mn, 31/12)						
Cash flow from operating activities	-26.82	24.95	17.64	27.58	33.29	42.47
Cash flow from investing activities	-10.66	-2.03	-17.04	-19.49	-20.48	-22.50
Cash flow from financing activities	-1.07	-22.77	1.01	-5.83	-18.05	-11.07
CHANGE IN CASH , CASH EQU.	**-38.54**	**0.14**	**1.61**	**2.27**	**-5.25**	**8.91**

Margins & Ratios	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Sales growth	1.8%	10.9%	15.7%	9.2%	9.3%	7.0%
EBITDA margin	18.3%	17.8%	17.2%	16.8%	16.2%	16.7%
EBIT margin	12.0%	12.4%	11.3%	10.6%	10.4%	10.7%
Net profit margin	5.5%	5.1%	7.1%	6.7%	7.0%	7.5%
ROE	4.9%	5.0%	7.3%	7.2%	7.9%	8.5%
ROCE	4.7%	4.4%	6.1%	6.7%	7.2%	7.7%
Equity ratio	64.2%	66.9%	64.1%	65.7%	66.3%	66.1%
Net debt	71.2	65.6	77.1	77.4	80.6	78.7
Working capital	96.9	107.7	125.8	140.8	155.9	170.9
Capital employed	327.2	342.1	378.5	391.9	410.7	424.2
Inventory turnover	1.6	1.8	2.1	2.1	2.1	2.2

Source: Company data, Erste Group estimates

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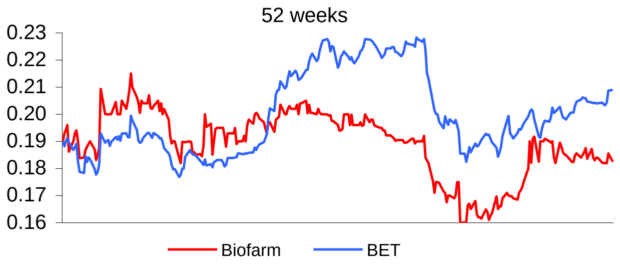
Biofarm

Accumulate

RON mn	2011	2012e	2013e	2014e
Net sales	93.4	100.4	110.2	126.3
EBITDA	21.0	26.5	28.3	31.4
EBIT	16.1	20.9	22.1	24.6
Net result after min.	14.5	19.3	19.2	21.1
EPS (RON)	0.01	0.02	0.02	0.02
CEPS (RON)	0.02	0.02	0.02	0.03
BVPS (RON)	0.14	0.14	0.15	0.17
Div./share (RON)	0.01	0.01	0.01	0.01
EV/EBITDA (x)	6.5	5.9	5.7	4.7
P/E (x)	14.5	10.4	10.4	9.5
P/CE (x)	10.6	8.7	7.9	7.2
Dividend Yield	5.2%	7.2%	7.2%	7.9%

Share price (RON) close as of 10/09/2012	0.1825
Number of shares (mn)	1,094.9
Market capitalization (RON mn / EUR mn)	200 / 45
Enterprise value (RON mn / EUR mn)	157 / 35



Performance	12M	6M	3M	1M
in RON	-6.4%	-7.6%	10.6%	-1.4%

Reuters	BIOF.BX	Free float	57.0%
Bloomberg	BIO RO	Shareholders	SIF Oltenia (17.0%)
Div. Ex-date	09/05/12		SIF Banat Crisana (14%)
Target price	**0.2180**	Homepage:	www.biofarm.ro

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Robust performance in difficult market

We stick to our Accumulate call, with a target price of RON 0.218. There are four main reasons behind our positive stance on this stock: i) the strong 1H12 performance in a troubled market, which makes us confident that the FY results will have a similar tone; ii) the concrete actions to boost exports, in order to mitigate the tougher domestic market environment; iii) the lack of bank debt and high ability to keep costs under tight control; and iv) the company's status as a dividend payer starting this year.

The strong mid-year performance, triggered by 2Q results that were well above expectations (i.e. considering the market development), and the rosy outlook for the remaining of the year pave the way for solid FY12 results, in line with the previous years' robust and profitable growth.

The clawback expense, although significantly higher after the last tax-mechanism update, has not had a detrimental impact on profits, with the company having enough room to mitigate its effect and keep margins at the elevated levels to which investors have become accustomed. A strong OTC drug portfolio, with traditional brands at prices on the lower end of the market price range, secures a key competitive advantage in a tough business environment.

Biofarm has this year joined the ranks of dividend payers on the BSE and the 75% payout ratio for FY11 will most likely be maintained for at least two more years, given the cash needs of its main shareholders (three SIFs, which hold a majority), in order to fund their aggressive dividend policies.

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1H12 results review

Impressive 1H12 results bode well for strong FY12 performance

We were positively surprised by the company's 1H12 results, which were boosted by a very strong performance in 2Q. While in 1Q net sales decreased roughly 5% y/y, in the second quarter, a 23% jump was recorded, with both developments in contrast with the core OTC market trend. Thus, according to market research company Cegedim, OTC sales in Romania advanced 26.7% in the first quarter and significantly decelerated in the second quarter to just 7% y/y. The company's performance in 1H12 confirms its key competitive strength - its affordable product prices, which are at the lower end of the market range.

Despite their weight of <5% of sales and only tiny contribution to the sales growth rate, it is worth mentioning exports' roughly 50% advance in 1H12, thanks to brisk expansion in Russia/CIS.

RAS	2Q12	2Q11	y/y	1H12	1H11	y/y
Net sales (RON mn)	25.66	20.90	22.8%	52.92	49.48	7.0%
Operating profit (RON mn)	7.37	4.32	70.5%	15.32	12.76	20.0%
Adj. operating profit (RON mn)	7.83	4.18	87.4%	15.78	12.68	24.5%
Net profit (RON mn)	5.60	5.00	12.1%	12.28	11.01	11.5%
Adj. operatIng margin	*30.5%*	*20.0%*		*29.8%*	*25.6%*	
Net margin	*21.8%*	*23.9%*		*23.2%*	*22.3%*	

Source: Biofarm Bucuresti, Erste Group Research

Supported by the strong sales performance and good cost control, operating profit in 1H12 came in 20% higher y/y, while net profit advanced 11%.

Change in estimates/outlook

Fierce competition in core domestic OTC market shrinks room for profitability growth in medium term

For FY12, we expect net sales at RON 100.4mn, slightly lower than we anticipated earlier, due to the looming deceleration of drug sales and still mounting competition in the company's core OTC segment, given the shorter payment terms compared with the Rx segment. OTC drug sales account for only 20% of total sales in Romania, giving cause for concern regarding the budget that the company should assign for product promotion in order to compete with the much stronger multinational producers.

RAS		2012e			2013e	
(RON, mn)	Now	Before	*Change*	Now	Before	*Change*
Net sales	100.4	102.3	*-1.9%*	110.2	110.9	*-0.7%*
EBITDA	26.5	25.6	*3.4%*	28.3	28.5	*-0.6%*
EBIT	20.9	20.2	*3.6%*	22.1	22.3	*-0.7%*
Net profit adj.	19.3	18.7	*3.2%*	19.2	19.4	*-1.0%*
EBITDA margin	*26.4%*	*25.0%*		*25.7%*	*25.7%*	
EBIT margin	*20.8%*	*19.7%*		*20.1%*	*20.1%*	
Net margin	*19.2%*	*18.3%*		*17.4%*	*17.5%*	

Source: Erste Group Research

Exports should become business driver starting in 2013

By the same rationale, we lowered the forecast of sales on the domestic market from 2013 on. Meanwhile, based on our discussions with management, we assume brisk growth of exports up to 2014, estimated to reach EUR 4mn by that date, from just EUR 0.8mn last year. Russia, Ukraine and the former Soviet countries are the main target markets. The contribution of exports to sales would thus surpass the 5% threshold. In summary, we envisage the company's sales increasing at a CAGR of ~9.5% over the detailed forecast period.

High marketing expenses (due to tough competition) and clawback tax as main threats to margins

Marketing expenses remain the key challenge in terms of both domestic and foreign campaigns. We stick to our previous assumption of an approx. 30% weight in sales for marketing expenses.

Clawback tax expenses, although significantly lower compared with those of peer Antibiotice (given Biofarm's focus on OTC drugs, which are not affected by this system), increased significantly to about RON 0.8mn/year (from about RON 0.3mn), as a result of changes to the taxation mechanism. We are confident that management will find ways to mitigate the impact of this tax and keep profitability at the elevated levels to which investors have become accustomed.

Consequently, we stick to our scenario in which an operating margin of 19-20% over the detailed forecast period is a realistic target. The FX risk stems from the large amount of imported raw materials, with company affected when LC depreciates. Based on our computes (i.e. raw material expense/ sales), Biofarm successfully managed to pass through the higher raw material costs in product prices. Raising exports will lead to a natural hedge in the coming years, for this reason we do not see FX risk as major reason for concern.

Dividends from revaluation of stock portfolio to support this year's net result

There is one further reason, aside from the sound and stable operating performance, for this stock to be on investors' radars. It is a certainty that the three closed-end funds that together hold the majority stake in Biofarm plan to milk this cash cow for dividends. Last year, 75% of profit was paid out as a dividend and we expect this to continue for at least the coming 2-3 years. In order to avoid any confusion, we did not include in our forecast scenario the impact of dividends or the revaluation (made at year-end) of the stock portfolio. We expect a net positive impact on the company's profit this year, thus providing further fuel for dividends.

The large dividend payments will erode the company's cash position, but not to such an extent that Biofarm would have to take bank loans to fund working capital needs or development plans. The company's ability to generate strong and stable cash flows from operations and its reduced CAPEX needs allow for a comfortable cash position and zero debt in the medium term.

Recommendation and target price

Rating kept at Accumulate, target price RON 0.218

We stick to our Accumulate call, with a target price of RON 0.218. There are four main reasons behind our positive stance on this stock: i) the strong 1H12 performance in a troubled market, which makes us confident that the FY results will have a similar tone; ii) the concrete actions to boost exports, in order to mitigate the tougher domestic market environment; iii) the lack of bank debt and high ability to keep costs under tight control; and iv) the company's status as a dividend payer starting this year.

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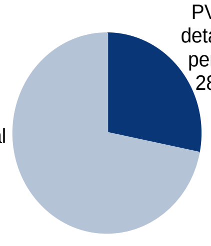
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	6.8%	6.8%	6.8%	6.8%	6.8%	5.5%
Equity risk premium	7.2%	7.2%	7.2%	7.2%	7.2%	6.7%
Beta	1.1	1.1	1.1	1.1	1.1	1.0
Cost of equity	**14.7%**	**14.7%**	**14.7%**	**14.7%**	**14.7%**	**12.2%**
Cost of debt	9.3%	9.3%	9.3%	9.3%	9.3%	8.0%
Effective tax rate	20.0%	20.0%	20.0%	20.0%	20.0%	19.0%
After-tax cost of debt	**7.4%**	**7.4%**	**7.4%**	**7.4%**	**7.4%**	**6.5%**
Equity weight	90%	90%	90%	90%	90%	90%
WACC	**13.9%**	**13.9%**	**13.9%**	**13.9%**	**13.9%**	**11.6%**

DCF valuation

(RON mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Sales growth	*9.8%*	*14.7%*	*8.0%*	*7.4%*	*7.4%*	*5.5%*
EBIT	22.1	24.6	26.9	30.2	30.2	31.6
EBIT margin	*20.1%*	*19.5%*	*19.7%*	*19.2%*	*19.2%*	*19.0%*
Tax rate	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*19.0%*
Taxes on EBIT	-4.4	-4.9	-5.4	-6.0	-6.0	-6.0
NOPLAT	**17.7**	**19.7**	**21.5**	**24.2**	**24.2**	**25.6**
+ Depreciation	6.2	6.7	7.3	7.8	7.8	8.5
Capital expenditures / Depreciation	*187.8%*	*156.7%*	*133.5%*	*122.1%*	*122.1%*	*100.0%*
+/- Change in working capital	-2.5	-4.3	-3.7	-3.3	-3.6	-2.6
Chg. working capital / chg. Sales	*-25.3%*	*-26.6%*	*-36.2%*	*-32.8%*	*-32.9%*	*-30.0%*
- Capital expenditures	-11.7	-10.6	-9.7	-9.5	-9.5	-8.5
Free cash flow to the firm	**9.8**	**11.6**	**15.4**	**18.9**	**18.9**	**23.0**
Terminal value growth						*2.0%*
Terminal value						244.5
Discounted free cash flow - Dec 31 2012	8.6	8.9	10.4	11.2	9.8	124.8
Enterprise value - Dec 31 2012	**173.8**					
Minorities	0.0					
Non-operating assets	0.0					
Net debt	-42.7					
Other adjustments	0.0					
Equity value - Dec 31 2012	**216.5**					
Number of shares outstanding (mn)	1,094.9					
Cost of equity	14.7%					
12M target price per share (RON)	**0.218**					
Current share price (RON)	0.183					
Up/Downside	*19.4%*					

Enterprise value breakdown



Sensitivity (per share)

WACC	Terminal value EBIT margin: 18.0%	18.5%	19%	19.5%	20.0%
10.6%	0.224	0.228	0.233	0.237	0.241
11.1%	0.217	0.221	0.225	0.229	0.233
11.6%	0.211	0.214	**0.218**	0.222	0.225
12.1%	0.205	0.208	0.212	0.215	0.219
12.6%	0.199	0.203	0.206	0.209	0.213

WACC	Terminal value Hrowth: 1.0%	1.5%	2.0%	2.5%	3.0%
10.6%	0.218	0.225	0.232	0.241	0.251
11.1%	0.212	0.218	0.225	0.232	0.241
11.6%	0.206	0.212	**0.218**	0.225	0.232
12.1%	0.201	0.206	0.212	0.218	0.225
12.6%	0.196	0.201	0.206	0.212	0.218

Source: Erste Group Research

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Income Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(RAS, RON mn, 31/12)	31/12/2009	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014
Net sales	**67.11**	**82.29**	**93.44**	**100.38**	**110.18**	**126.34**
Invent. changes + capitalized costs	1.49	0.96	-0.10	0.00	0.00	0.00
Total revenues	**68.60**	**83.25**	**93.34**	**100.38**	**110.18**	**126.34**
Other operating revenues	0.14	0.32	0.32	0.05	0.00	0.00
Material costs	-20.57	-24.93	-29.41	-30.61	-33.99	-41.06
Personnel costs	-13.08	-14.26	-14.38	-15.38	-15.54	-16.00
Other operating expenses	-16.84	-22.75	-28.81	-27.97	-32.31	-37.89
EBITDA	**18.25**	**21.63**	**21.04**	**26.46**	**28.34**	**31.39**
Depreciation/amortization	-4.54	-4.70	-4.94	-5.54	-6.20	-6.75
EBIT	**13.71**	**16.93**	**16.10**	**20.92**	**22.14**	**24.64**
Financial result	8.88	0.10	1.09	2.05	0.74	0.49
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**22.59**	**17.04**	**17.20**	**22.97**	**22.87**	**25.13**
Income taxes	-2.95	-3.43	-2.68	-3.68	-3.66	-4.02
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	0.00	0.00	0.00	0.00	0.00	0.00
Net result after minorities	**19.64**	**13.60**	**14.52**	**19.30**	**19.21**	**21.11**

Balance Sheet	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(RAS, RON mn, 31/12)						
Intangible assets	1.25	1.16	0.87	2.93	3.10	3.30
Tangible assets	58.51	53.61	56.69	79.90	85.18	88.80
Financial assets	13.04	12.74	11.10	11.10	11.10	11.10
Total fixed assets	**72.79**	**67.51**	**68.66**	**93.93**	**99.38**	**103.21**
Inventories	11.28	13.55	15.23	18.15	20.53	23.54
Receivables and other current assets	32.43	19.78	26.43	23.93	26.87	30.81
Other assets	0.17	0.22	0.27	0.00	0.00	0.00
Cash and cash equivalents	37.41	67.17	74.23	42.75	38.71	51.50
Total current assets	**81.29**	**100.72**	**116.17**	**84.82**	**86.10**	**105.84**
TOTAL ASSETS	**154.08**	**168.23**	**184.83**	**178.76**	**185.48**	**209.05**
Shareholders'equity	**136.05**	**145.76**	**154.25**	**156.18**	**160.99**	**182.10**
Minorities	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
LT provisions	**4.89**	**3.36**	**3.88**	**2.05**	**2.05**	**2.05**
Interest-bearing LT debts	0.00	0.00	0.00	0.00	0.00	0.00
Other LT liabilities	0.85	0.84	0.40	0.72	0.70	0.67
Total long-term liabilities	**0.85**	**0.84**	**0.40**	**0.72**	**0.70**	**0.67**
Interest-bearing ST debts	0.00	0.00	0.00	0.00	0.00	0.00
Other ST liabilities	12.29	18.27	26.30	19.80	21.74	24.23
Total short-term liabilities	**12.29**	**18.27**	**26.30**	**19.80**	**21.74**	**24.23**
TOTAL LIAB. , EQUITY	**154.08**	**168.23**	**184.83**	**178.76**	**185.48**	**209.05**

Cash Flow Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(RAS,RON mn, 31/12)						
Cash flow from operating activities	4.49	31.20	16.57	9.20	19.90	23.91
Cash flow from investing activities	-2.81	-4.69	-5.09	-5.52	-7.90	-6.99
Cash flow from financing activities	-0.72	3.26	-4.42	-35.17	-16.05	-4.14
CHANGE IN CASH , CASH EQU.	**0.96**	**29.77**	**7.06**	**-31.48**	**-4.04**	**12.79**

Margins & Ratios	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Sales growth	3.1%	22.6%	13.5%	7.4%	9.8%	14.7%
EBITDA margin	26.6%	26.0%	22.5%	26.4%	25.7%	24.8%
EBIT margin	20.0%	20.3%	17.3%	20.8%	20.1%	19.5%
Net profit margin	28.6%	16.3%	15.6%	19.2%	17.4%	16.7%
ROE	14.8%	9.7%	9.7%	12.4%	12.1%	12.3%
ROCE	17.0%	12.8%	14.6%	16.8%	14.8%	15.4%
Equity ratio	88.3%	86.6%	83.5%	87.4%	86.8%	87.1%
Net debt	-37.4	-67.2	-74.2	-42.7	-38.7	-51.5
Working capital	68.8	82.2	89.6	65.0	64.4	81.6
Capital employed	104.4	82.8	84.3	116.2	125.0	133.3
Inventory turnover	1.6	1.8	1.9	1.7	1.6	1.6

Source: Company data, Erste Group estimates

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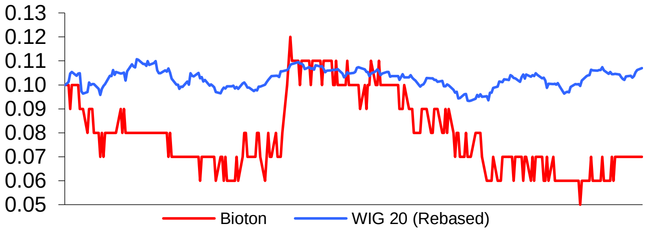
ERSTE GROUP

Bioton

Hold

PLN mn	**2011**	**2012e**	**2013e**	**2014e**
Net sales	289.0	392.5	370.7	403.4
EBITDA	-14.0	84.8	59.6	89.3
EBIT	-51.1	48.1	20.2	47.3
Net result after min.	-78.9	50.9	13.8	36.8
EPS (PLN)	-0.01	0.01	0.00	0.01
CEPS (PLN)	-0.01	0.01	0.01	0.01
BVPS (PLN)	0.18	0.18	0.18	0.18
Div./share (PLN)	0.00	0.00	0.00	0.00
EV/EBITDA (x)	-59.0	10.7	14.8	9.4
P/E (x)	nm	9.7	37.2	13.9
P/CE (x)	-8.1	5.7	9.6	6.5
Dividend Yield	0.0%	0.0%	0.0%	0.0%

52 weeks



Performance	**12M**	**6M**	**3M**	**1M**
in PLN	-30.0%	-30.0%	0.0%	16.7%

Share price (PLN) close as of 10/09/2012	0.0700
Number of shares (mn)	7,302.5
Market capitalization (PLN mn / EUR mn)	511 / 124
Enterprise value (PLN mn / EUR mn)	904 / 220

Reuters	BOTN.WA	Free float	72.0%
Bloomberg	BIO PW	Shareholders	Prokom Investm. (13.9%)
Div. Ex-date			Ryszard Krauze (5.49%)
Target price	**0.0700**	Homepage:	www.bioton.pl

Analyst:
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Bioton turnaround story: more patience needed

The medium- to long-term benefits from the Actavis cooperation contract, promising to shore up Bioton's position in the insulin product niche as well as its profitability, remain the key rationale for institutional investors to keep Bioton on their watch list. Nevertheless, the road to their full materialization is still bumpy, with the acquisition of veterinary manufacturer Biolek bringing dilutive effects and increasing the opacity of Bioton's outlook for the time being. Factoring in the somewhat slower progress towards sustainable profitability, our revised 12M DCF-derived target price arrives at PLN 0.07 per share. All told, we see no reason to rush into the stock and stick to our Hold recommendation.

The major changes incorporated into our model include: 1) the negative impact of the Polish pharma market regulatory turmoil on domestic sales; 2) the more subdued tempo of insulin sales in China and Ukraine; 3) the less sizable initial contribution from Biolek to sales and profitability; 4) one-off gains linked to the Israeli plant disposal; 5) the slower progress in enhancing gross profitability; 6) delays in the timing of the next milestones linked to signing the Actavis cooperation contract; and 7) the more dilutive effects of capital hikes linked to the Biolek acquisition.

Incorporating the delays in reaping benefits from the Biolek consolidation and the Indar contract as well as less robust sales in the Polish insulin market, we trim our sales target for 2012 to PLN 392.5mn. Furthermore, while we expect the underlying profitability progress to be less remarkable, backed by the profound effect of the Actavis deal, we still see both the operating and bottom lines safely in the black. Nevertheless, we cut our operating profit target to PLN 48.1mn and revise our net profit forecast to PLN 50.9mn profit (down 22.6% vs. our earlier target).

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Changes in forecast/outlook

The milestone payment related to the Actavis cooperation deal gave a boost to Bioton's sales in 1Q12. Nonetheless, the subsequent quarter already provided evidence that Bioton is still struggling both at home as well as in bringing some of the earlier signed contracts fully on stream.

Similarly to previous years, the company's top line developments have been volatile in the course of the first half of 2012, with the y/y comparison distorted by the impact of one-off items. The signing of the Actavis cooperation deal had a profound impact in this respect. The related milestone payment (EUR 22.25mn or PLN 94.7mn) gave a boost to Bioton's sales in 1Q12. Nonetheless, the subsequent quarter already provided evidence that Bioton is still struggling both at home as well as in bringing some of the earlier signed contracts fully on stream. In 2Q12, Bioton's sales slipped 14.1% y/y to PLN 69.0mn, sending the 1H12 top line to PLN 230.5mn, 8% behind our forecast. (With respect to the disposal of the Israeli business, the company restated its 2011 interim results, recording the results of the discontinued business as a separate item below the result from the continuing operations. As this change was made public only at the time of announcement of 1H12 unaudited results, our projections were based on the original reporting format, i.e. factoring in the Israeli unit as an integral part of Bioton operations.)

We continue to assume that, going forward, the insulin segment will dominate Bioton's sales structure.

We continue to assume that, going forward, the insulin segment will dominate Bioton's sales structure, with the export tempo fueled by the numerous cooperation contracts. First of all, **based on the contract with Germany's Bayer** (signed in June 2009 and valid until 2015), **Bioton supplies its partner with insulin for the Chinese market**. In 2010, for the exclusive right to market and distribute insulin produced by Bioton under the trade name SciLin in China, Bayer committed to pay Bioton an upfront payment of EUR 31mn and - after some delays - the first insulin deliveries started in September 2010. However these are still uneven, in particular on a quarterly basis. In 1H12, Bioton's insulin sales in China amounted to just PLN 1.1mn. According to the revised company guidance, in 2012, sales are expected to amount to some PLN 10-15mn and to more than double y/y in 2013 (to exceed PLN 30mn). Secondly, in December 2010, Bioton inked an agreement with GlaxoSmithKline (GSK) and the first shipments within the frame of the **GSK contract in Russia** commenced as planned in September 2011. For the full-year 2012, they are anticipated to reach PLN 5mn and advance further to some PLN 8-9mn in 2013. Last but not least, **based on the contract with Indar ZAO, Bioton aims to return to the Ukrainian market.** While at the time of signing Bioton announced that deliveries are envisaged at around PLN 21mn on an annual basis for the next three years, due to the slipping deadlines linked to registration of products, sales are now estimated to start in 4Q12 only (and amount to just PLN 1-3mn in 2012).

Bioton's domestic sales should recover in the remaining part of 2012 and see solid growth in the coming years.

Reflecting the high volatility on the market and the high level of inventories at wholesalers at the beginning of the year (dampening 1Q, but also to a certain extent the 2Q12 sales tempo), in 1H12, **Bioton's domestic sales of insulin** amounted to just PLN 25.6mn. The recent regulatory changes (with some of the long-acting analogs returning to the reimbursement list) slightly compromised Bioton's recently reinforced position on the Polish market. Nonetheless, with the basic human insulin made by Bioton keeping its full reimbursement status as well as price competitiveness, Bioton's domestic sales should recover in the remaining part of 2012 and see solid growth in the coming years. Furthermore, the company is set to benefit from the sales expansion of complementary products for diabetes care (an insulin pen and glucometer distribution deal with ARKRAY) as well as new product launches. In summary, factoring in the less robust than earlier envisaged home market sales pace, along with delays in initial shipments within the Indar contract and somewhat less pronounced sales in China in 2012, we decrease our assumptions for Bioton's total 2012 insulin sales to PLN 119mn, out of which some PLN 71.5mn is to be delivered by domestic sales. The contributions from the Italian companies to the 1H12 top line stood at PLN 31.3mn. Hence we leave our forecasts unchanged here and for 2012 we continue to project low single-digit-term growth, bringing the sales contribution from the Italian business to around PLN 57.4mn in total.

In 2012, Bioton will for the first time fully consolidate Biolek.

In 2012, Bioton will for the first time fully consolidate Biolek, the veterinary products manufacturer acquired in late 2011. While the original guidance from the company assumed Biolek bringing in some PLN 50mn in sales in 2012, due to postponements in product registrations and launches on the export markets, including the crucial Chinese one, the company now anticipates that Biolek sales in China will start only in 4Q12, amounting to PLN 15-20mn in 2012. For 2013, however, the projected tempo is very steep, with sales eventually surpassing PLN 100mn. To be on the safe side, however, we opt to stick to our original forecast here (of around PLN 55mn for 2013), while cutting the 2012 estimate to PLN 16.5mn. Last but not least, our projections incorporate the sizable first milestone linked to the signing of the Actavis cooperation contract. In total, Bioton is entitled to obtain EUR 55.5mn for its insulin distribution rights in the EU, US and Japan, out of which some EUR 22.25mn was recorded already in 1Q12, with the rest subject to the achievement of certain milestones on bringing insulin to the respective markets in 2013-15.

With contribution from Biolek, Ukrainian comeback facing delays and Polish sales tempo hampered by regulatory turmoil, we trim our 2012 top line target to PLN 392.5mn.

In summary, reflecting the above-mentioned changes, we revise our 2012 sales forecast from PLN 481.9mn to PLN 392.5mn. While we continue to assume that the new dynamism in the Chinese, Russian and Ukrainian markets will lend momentum to Bioton's top line in the coming periods, with respect to the significantly less sizable one-offs (reflecting the latest company guidance, we expect an Actavis deal related payment of EUR 1mn, down from the earlier projected EUR 5mn) as well as lower comparative base, we lower our 2013 target from PLN 471mn to PLN 370.7mn. (Should the company obtain milestone payments linked to the pending EMEA registration of human growth hormone sustained release product, estimated to reach up to EUR 10-20mn, the picture might be brighter. Nonetheless, given the track record of delays past original deadlines, we leave this option out of our valuation for the time being.)

Gross profit: Pace of improvements remains slow, benefits from Biolek consolidation to be visible only from 2013 onwards.

While, thanks to the Actavis milestone, the reported gross margin was very impressive (at 60.8%), excluding one-offs, gross profitability remained subdued in 1H12, with a gross margin of a mere 33.5%. The 1H12 gross margin slightly surpassed our adjusted expectations (32%); with the benefits stemming from the Biolek consolidation (with an estimated gross margin of 40-50%) to kick in later in 4Q12, we opt to make a minor upward revision to our 2012 gross margin target, from 50.1% to 51.0%. Nevertheless, we want to stress that this figure is not sustainable going forward and the milestone payment from Actavis (at EUR 22.25mn in 1Q12) remains the major factor behind the progress in 2012, with the underlying gross margin now envisaged at 35.4%. As before, we expect a more favorable sales mix (with recovery of domestic insulin sales) as well as better efficiencies (including savings connected with the disposal of non-core assets) and full benefits from Biolek consolidation to support the improving trend in the coming years. Nonetheless, in the absence of a comparable sizable one-off to the Actavis deal in 2013, we anticipate the gross margin on the reported level to head south to 45.1% (but somewhat above the earlier estimated 42.8%).

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Thanks to Actavis transaction related milestone, operating line set to swing into black.

In 1H12, operating expenses surpassed our expectations, due in particular to the still relatively high G&A expenses (hiked by costs for legal services associated with numerous transactions underway). Following acceleration in 2Q (up 28.5% q/q), in 1H12, administrative and general costs were 9.5% higher than we projected. Consequently, we are prompted to increase our 2012 forecast by 4.5% compared to our previous estimate of PLN 96.1mn. On the other hand, while sales and marketing costs gathered momentum, reflecting the company's expanding activities in its home insulin market, their full year tempo seems to be somewhat less steep than we originally anticipated. Hence, we opt to fine-tune our assumptions for 2012 and project sales and marketing costs at around PLN 56.8mn, down 2% compared to our previous forecast. In summary, reflecting the worse than estimated 1H12 operating line performance and the less encouraging outlook for 2H12 (with sales contribution from Indar and Biolek less sizable than originally expected), despite the significant impact of the Actavis deal related income, our new 2012 operating profit target arrives at PLN 48.1mn, translating into an operating profit margin of 12.2%. However, excluding the buoying effect of the Actavis cooperation deal related income, we now assume the operating line ending at a loss of PLN 46.7mn (vs. our previous estimate of a PLN 1.2mn operating profit) in 2012. For 2013, as we continue to anticipate improvements in underlying gross profitability, along with the improving operating cost control, our operating profit target arrives at PLN 20.2mn, down 58% y/y as reported, but significantly up y/y on a comparable basis (i.e. excluding the Actavis deal related income from both the 2012 and 2013 figures).

Nevertheless, with underlying operating profitability parameters weaker than originally expected, we cut our EBIT target to PLN 48.1mn and envisage 2013 operating line retreating 58% y/y.

Changes to 2012 and 2013 forecasts

Consolidated, IFRS	**2012e**			**2013e**		
(PLN, mn)	**Now**	**Before**	*Change*	**Now**	**Before**	*Change*
Net sales	**392.5**	**481.9**	***-18.6%***	**370.7**	**471.0**	***-21.3%***
Costs of goods sold	192.5	240.6	*-20.0%*	203.6	269.6	*-24.5%*
Gross profit	**200.0**	**241.3**	***-17.1%***	**167.1**	**201.4**	***-17.1%***
Sales & marketing exp.	56.8	57.9	*-2.0%*	57.3	60.8	*-5.7%*
General & admin. exp.	100.4	96.1	*4.5%*	95.3	97.0	*-1.7%*
Other operating income	13.2	13.0	*1.2%*	13.0	12.8	*1.2%*
Other operating exp.	8.0	8.0	*0.0%*	7.2	7.8	*-8.6%*
Operating profit	**48.1**	**92.4**	***-48.0%***	**20.2**	**48.6**	***-58.4%***
Financial result	-7.6	-13.3	*-42.8%*	-6.8	-10.8	*-36.9%*
Pre-tax profit	**40.5**	**79.1**	***-48.8%***	**13.4**	**37.8**	***-64.6%***
Income taxes	4.0	15.0	*-73.1%*	2.5	7.2	*-64.6%*
Profit/loss on discont.operations	12.8	0.0	*n.m.*	0.0	0.0	*0.0%*
Minority interest	2.2	1.7	*31.1%*	2.9	1.8	*66.0%*
Net income	**50.9**	**65.8**	***-22.6%***	**13.8**	**32.4**	***-57.5%***
Gross margin	51.0%	50.1%		45.1%	42.8%	
EBIT margin	12.2%	19.2%		5.4%	10.3%	
Net margin	13.0%	13.7%		3.7%	6.9%	

Source: Erste Group Research

Pushed up by Actavis related deal proceeds and bolstered by accounting for gains on discontinued operations coupled with tax losses carried forward, net profit is expected to reach PLN 50.9mn in 2012.

Reflecting the more favorable forex situation in 2Q12 (which also pushed up recorded income on the sale of a stake in Hefei- SciGen-BIOTON Biopharmaceutical Company LTD (HSBBC)), the company's financial result ended in black territory in 1H12 at a financial profit of PLN 0.8mn (vs. the 1Q12 loss of PLN 16.1mn and our forecast of a 1H12 financial loss of PLN 18.9mn). In addition, the company recorded a gain on discontinued operations, namely on the disposal of SciGen Israel (including the license for Sci-B-Vac), totaling PLN 13.1mn. Nonetheless, going forward, we remain cautious, as the forex situation remains quite volatile this year and in our opinion forex related financial expenses (in particular, forex and possible investment revaluation related losses) continue to pose a threat to the financial result. The recorded profits of PLN 3.8mn on the HSBBC sale and (most importantly) the gain on the SciGen Israel disposal are subject to revaluation in subsequent periods, should the forex situation change. (Out of the recorded gain of PLN 13.1mn on the SciGen Israel transaction, the vast majority, PLN 12.6mn, was achieved due to a forex gain based on the end of the period PLN /USD rate.) Nevertheless, with the 1H12 financial result significantly better than we envisaged, we opt to fine-tune our 2012 forecast from a financial loss of PLN 13.3mn to a financial loss of PLN 7.6mn. In addition, assuming a slight firming of the PLN vs. the USD towards the end of the year, we incorporate into our forecast a gain on discontinued operations of PLN 12.8mn. Although the tax situation is difficult to assess, based on the recent guidance, we expect the company to continue in the activation of tax losses carried forward in the coming periods, reducing the effective tax rate below the statutory one. Factoring in the tax relief, we revise our net profit forecast from PLN 65.8mn to PLN 50.9mn for 2012. For 2013, we remain on the conservative side and, reflecting the significantly less sizable impact of positive one-offs, we project net profit of PLN 13.8mn, down 73% y/y as reported.

1H12 results review

Bioton published its 1H12 results on August 31, 2012, wrapping up the reporting season in the CEE pharma universe.

1H12 results review

IFRS consolidated	2Q2012	2Q2011	*y/y*	1H2012	1H2011	*y/y*
Total sales (PLN 000)	69,025	80,335	*-14.1%*	230,509	134,706	*71.1%*
Operating profit (PLN 000)	-16,319	-12,213	*33.6%*	63,254	-26,817	*n.m.*
Net income (PLN 000)	13,735	-18,123	*n.m.*	66,179	-34,323	*n.m.*
Operating margin	*-23.6%*	*-15.2%*		*27.4%*	*-19.9%*	
Net margin	*19.9%*	*-22.6%*		*28.7%*	*-25.5%*	

Source: Bioton, 2Q11 and 1H11 results were restated

Buoyed by the Actavis deal related milestone (EUR 22.25mn or PLN 94.7mn), sales climbed 71.1% y/y to PLN 230.5mn and the operating and bottom lines were pushed up into black territory, to an operating profit of PLN 63.3mn and net profit of PLN 66.2mn (vs. the year-earlier operating loss of PLN 26.8mn and net loss after minorities of PLN 34.3mn.) Nonetheless, excluding the milestone related boost, the underlying performance was rather weak, as Bioton would have recorded an operating loss of PLN 31.5mn. Also, Bioton's consolidated sales would have been nearly flat at PLN 135.8mn (up a mere 0.8% y/y), as sales in the Polish market continued to be hampered by the unstable pharmaceutical market situation linked to the regulatory changes from January 2012, with inventory buildup at distributors before the end of 2011, followed by a rather dramatic drop in domestic sales. In 1H12, the parent company's sales plunged 16.8% y/y to PLN 46.9mn, out of which insulin sales contributed PLN 25.6mn (down 23.5% y/y). The still rather grim picture is also illustrated by 2Q12 alone, when Bioton's sales retreated 14.1% y/y to PLN 69.0mn, while the operating loss widened from PLN 12.2mn to PLN 16.3mn. Nevertheless, thanks to the forex gain-driven y/y turnaround in the financial result, combined with a gain on discontinued operations (disposal of SciGen Israel, including the sale of the license for Sci-B-Vac, bringing in PLN 13.1mn), the company managed to post net profit of PLN 13.7mn (all based on consolidated figures).

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Valuation / Recommendation

We revise our 12-month target price to PLN 0.07 and stick to Hold. With business outlook remaining rather opaque and related uncertainties not allowing for full incorporation of possible benefits from recent deals, we see no reason to rush into stock.

With Bioton's home country's S&P rating unchanged since our last update in March 2012, based on our unified methodology for setting the equity risk premium, we stick to applying the equity risk premium for 2013-17 of 6.0% and 5.7% for perpetuity. With Polish 10-year government bond yields somewhat below the level reached in spring 2012, we adjust the risk-free rate applied in our DCF model to 5.1% (vs. the earlier 5.8%). The acquisition of Biolek, with the purchase price for the veterinary producer further enhanced, based on the achieved milestone events (all paid for in Bioton shares), brought additional dilutive effects, with the number of shares issued by the end of June 2012 up 8.6% compared to our last update. Incorporating the forecast changes (including a changing timeframe and capital hike linked to the Biolek deal) into our model, we arrive at a 12-month target value of PLN 0.08 per share. We still think that the company's road to a sustainable operational turnaround might be rather bumpy, with many factors still difficult to predict. Transparency has not improved yet and stock volatility (due in part to low price levels) has increased considerably. We thus decided to stick to our earlier introduced risk related discount to our DCF-derived target price of 10%, yielding a new target price of PLN 0.07 (down from the PLN 0.11 per share targeted earlier).

Bioton's recent share price developments clearly show that, in times of market turbulence, investors are becoming more risk-averse and the stock had to pay a price for the missed deadlines and permanent postponements of the earlier scheduled deal closings. While the Actavis deal signing injected new life and a fresh wave of optimism, this quickly evaporated with the Biolek deal related dilutive waves. Investors became less patient, asking for more progress and visibility in terms of the company's outlook. Thus, although the stock price remained well below Bioton's book value of PLN 0.2 per share, the investment story has not been seen yet as sufficiently attractive for long-term-oriented investors. Sinking into single-digit terms, the volatility of the stock increased, making it suitable for speculative investors, rather than long-term ones.

We prefer to stick to our conservative stance. The future stock development might still be shaky, as, after the many delays accompanying the Actavis contract finalization, execution risks are still numerous and will be carefully watched by market participants. We also think that, apart from delivering in a timely manner on its promises, the company will also have to increase its transparency in order to attract, in particular, foreign institutional investors. Our revised 12-month target price of PLN 0.07 per share suggests that the stock adequately reflects the pros and cons of Bioton's investment case. Consequently, we leave our Hold recommendation unchanged for the time being.

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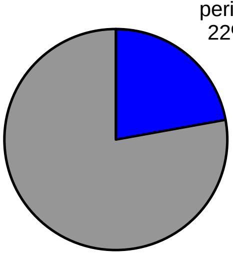
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	5.1%	5.1%	5.1%	5.1%	5.1%	5.0%
Equity risk premium	6.0%	6.0%	6.0%	6.0%	6.0%	5.7%
Beta	0.84	0.84	0.84	0.84	0.84	1.0
Cost of equity	**10.1%**	**10.1%**	**10.1%**	**10.1%**	**10.1%**	**10.7%**
Cost of debt	7.1%	7.1%	7.1%	7.1%	7.1%	7.0%
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
After-tax cost of debt	**5.8%**	**5.8%**	**5.8%**	**5.8%**	**5.8%**	**5.7%**
Equity weight	85%	85%	85%	85%	85%	86%
WACC	**9.5%**	**9.5%**	**9.5%**	**9.5%**	**9.5%**	**10.0%**

DCF valuation

(PLN mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Sales growth	*-5.6%*	*8.8%*	*11.6%*	*7.7%*	*9.2%*	*6.0%*
EBIT	20.2	47.3	71.5	87.8	102.9	106.7
EBIT margin	*5.4%*	*11.7%*	*15.9%*	*18.1%*	*19.4%*	*19.0%*
Tax rate	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*
Taxes on EBIT	-3.8	-9.0	-13.6	-16.7	-19.6	-20.3
NOPLAT	**16.4**	**38.3**	**58.0**	**71.1**	**83.4**	**86.4**
+ Depreciation	39.4	42.0	44.8	47.9	51.0	51.0
Capital expenditures / Depreciation	*99.1%*	*92.9%*	*87.1%*	*84.7%*	*82.5%*	*100.0%*
+/- Change in working capital	-1.1	-2.6	-2.5	-1.9	-1.8	-1.7
Chg. working capital / chg. Sales	*4.9%*	*-7.8%*	*-5.4%*	*-5.4%*	*-4.0%*	*-5.5%*
- Capital expenditures	-39.0	-39.0	-39.0	-40.5	-42.0	-51.0
Free cash flow to the firm	**15.6**	**38.7**	**61.2**	**76.6**	**90.5**	**84.7**
Terminal value growth						*2.5%*
Terminal value						1,157.3
Discounted free cash flow - Dec 31 2012	14.3	32.3	46.6	53.3	57.5	717.5
Enterprise value - Dec 31 2012	**921.5**					
Minorities	162.4					
Non-operating assets	0.0					
Net debt	230.7					
Other adjustments	0.0					
Equity value - Dec 31 2012	**528.4**					
Number of shares outstanding (mn)	7,302.5					
Cost of equity	10.1%					
12M target price per share (PLN)	**0.08**					
- risk related discount	10.0%					
12M target price per share (PLN)	0.07					
Current share price (PLN)	0.07					
Up/Downside	*0.0%*					

Enterprise value breakdown



Source: Erste Group Research

Sensitivity (per share)

WACC	Terminal value EBIT margin 18.0%	18.5%	19.0%	19.5%	20.0%
9.2%	0.08	0.08	0.08	0.08	0.09
9.7%	0.07	0.07	0.07	0.08	0.08
10.2%	0.06	0.07	**0.07**	0.07	0.07
10.7%	0.06	0.06	0.06	0.06	0.07
11.2%	0.05	0.06	0.06	0.06	0.06

WACC	Terminal value growth 1.5%	2.0%	2.5%	3.0%	3.5%
9.2%	0.07	0.07	0.08	0.09	0.10
9.7%	0.06	0.07	0.07	0.08	0.09
10.2%	0.06	0.06	**0.07**	0.07	0.08
10.7%	0.05	0.06	0.06	0.07	0.07
11.2%	0.05	0.05	0.06	0.06	0.07

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Income Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS, PLN mn, 31/12)	31/12/2009	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014
Net sales	**286.23**	**378.10**	**288.98**	**392.46**	**370.67**	**403.35**
Cost of goods sold	-174.92	-165.88	-186.40	-192.48	-203.61	-203.78
Gross profit	**111.31**	**212.21**	**102.59**	**199.98**	**167.06**	**199.57**
SG&A	-173.92	-153.17	-158.84	-157.12	-152.67	-157.92
Other operating revenues	22.14	43.86	15.50	13.17	12.97	12.78
Other operating expenses	-527.36	-12.84	-10.30	-7.96	-7.17	-7.16
EBITDA	**-536.74**	**128.71**	**-13.97**	**84.77**	**59.59**	**89.29**
Depreciation/amortization	-31.10	-38.64	-37.09	-36.69	-39.40	-42.02
EBIT	**-567.84**	**90.06**	**-51.06**	**48.07**	**20.20**	**47.27**
Financial result	-26.53	9.77	0.26	-7.58	-6.82	-5.56
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**-594.37**	**99.84**	**-50.80**	**40.49**	**13.38**	**41.72**
Income taxes	-5.51	-6.05	6.14	-4.05	-2.54	-7.93
Result from discontinued operations	0.00	16.94	-39.27	12.79	0.00	0.00
Minorities and cost of hybrid capital	53.21	6.45	5.08	1.71	2.92	2.96
Net result after minorities	**-546.67**	**117.18**	**-78.86**	**50.94**	**13.76**	**36.75**

Balance Sheet	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS, PLN mn, 31/12)						
Intangible assets	669.45	703.09	1,128.49	1,168.57	1,174.57	1,171.56
Tangible assets	427.14	392.24	424.38	466.32	476.66	483.50
Financial assets	62.64	51.19	78.25	74.32	80.36	86.94
Total fixed assets	**1,159.22**	**1,146.51**	**1,631.11**	**1,709.21**	**1,731.60**	**1,742.00**
Inventories	111.86	97.99	95.29	97.19	100.00	101.73
Receivables and other current assets	299.73	281.63	273.82	241.65	246.80	255.24
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	33.99	58.62	24.33	35.43	45.89	75.09
Total current assets	**445.58**	**438.24**	**393.44**	**374.27**	**392.69**	**432.06**
TOTAL ASSETS	**1,604.80**	**1,584.75**	**2,024.55**	**2,083.47**	**2,124.28**	**2,174.06**
Shareholders'equity	**1,004.06**	**1,093.70**	**1,197.06**	**1,281.45**	**1,279.01**	**1,317.75**
Minorities	**75.90**	**76.18**	**187.82**	**162.39**	**162.39**	**162.39**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
LT provisions	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Interest-bearing LT debts	20.48	113.52	126.06	135.51	128.73	122.30
Other LT liabilities	74.71	77.55	148.34	150.56	158.09	166.00
Total long-term liabilities	**95.19**	**191.07**	**274.40**	**286.07**	**286.83**	**288.29**
Interest-bearing ST debts	232.35	68.48	137.50	130.63	124.10	117.89
Other ST liabilities	197.31	155.32	227.78	222.93	271.96	287.74
Total short-term liabilities	**429.66**	**223.80**	**365.28**	**353.56**	**396.06**	**405.63**
TOTAL LIAB. , EQUITY	**1,604.80**	**1,584.75**	**2,024.55**	**2,083.47**	**2,124.28**	**2,174.06**

Cash Flow Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	-80.22	27.17	-22.20	73.67	62.80	80.88
Cash flow from investing activities	-127.97	57.98	-97.07	-65.15	-39.03	-39.03
Cash flow from financing activities	203.98	-82.18	84.98	2.58	-13.31	-12.64
CHANGE IN CASH , CASH EQU.	**-25.87**	**2.97**	**-34.29**	**11.10**	**10.46**	**29.20**

Margins & Ratios	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Sales growth	-2.5%	32.1%	-23.6%	35.8%	-5.6%	8.8%
EBITDA margin	-187.5%	34.0%	-4.8%	21.6%	16.1%	22.1%
EBIT margin	-198.4%	23.8%	-17.7%	12.2%	5.4%	11.7%
Net profit margin	-209.6%	24.8%	-15.5%	9.3%	2.9%	8.4%
ROE	-51.8%	11.2%	-6.9%	4.1%	1.1%	2.8%
ROCE	-38.2%	6.8%	-2.8%	2.7%	1.1%	2.4%
Equity ratio	67.3%	73.8%	68.4%	69.3%	67.9%	68.1%
Net debt	218.8	123.4	239.2	230.7	206.9	165.1
Working capital	15.9	214.4	28.2	20.7	-3.4	26.4
Capital employed	1,373.5	1,370.8	1,772.4	1,825.1	1,806.4	1,811.2
Inventory turnover	1.7	1.6	1.9	2.0	2.1	2.0

Source: Company data, Erste Group estimates

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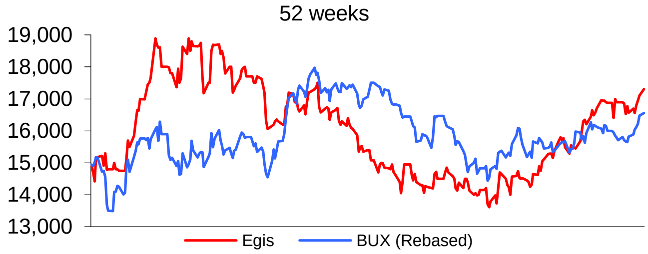
ERSTE GROUP

Egis

Buy

HUF mn	2011	2012e	2013e	2014e
Net sales	128,939.0	132,967.9	136,121.2	145,887.8
EBITDA	25,609.0	31,250.5	27,973.5	30,081.9
EBIT	16,302.0	21,210.6	17,308.3	18,739.7
Net result after min.	13,585.0	18,674.5	16,331.0	17,951.5
EPS (HUF)	1,744.86	2,398.56	2,097.57	2,305.69
CEPS (HUF)	2,943.85	3,704.07	3,476.20	3,771.72
BVPS (HUF)	20,760.93	23,039.50	25,017.06	27,202.75
Div./share (HUF)	120.00	120.00	120.00	120.00
EV/EBITDA (x)	3.6	3.2	3.3	2.8
P/E (x)	8.5	7.2	8.2	7.5
P/CE (x)	5.0	4.7	5.0	4.6
Dividend Yield	0.8%	0.7%	0.7%	0.7%

Share price (HUF) close as of 10/09/2012	17,300
Number of shares (mn)	7.8
Market capitalization (HUF mn / EUR mn)	134,693 / 473
Enterprise value (HUF mn / EUR mn)	101,518 / 357



Performance	12M	6M	3M	1M
in HUF	20.1%	12.7%	18.1%	3.5%

Reuters	EGIS.BU	Free float	49.1%
Bloomberg	EGIS HB	Shareholders	Servier (50.9%)
Div. Ex-date	19/04/12		
Target price	**22,850**	Homepage:	www.egis.hu

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Surfing on forint wave to stellar 2011/12

Factoring in changes to our Egis projections, including the new timeframe and lower risk-free rate, our DCF-derived 12-month target price arrives at HUF 22,850 per share, 11.7% above our previous target. Although the benefits from the weaker forint are set to become less prominent for Egis in the remaining part of the year, the company is on the best path to reaching record-breaking results in 2011/12. With home market woes compensated for by the healthy Russia/CIS performance and with the business outlook further lightened by Celltrion deal benefits (to kick in from 2013), Egis represents a very solid fundamentally-based investment case. Despite the recent stock rally, its valuation gap remains wide and multiples very appealing. We stick to our Buy call on the stock.

We have incorporated into our model: 1) the gloomier domestic market sales outlook for 2012/13; 2) the somewhat more sluggish sales in CEE markets in 2011/12, followed by a revival from 2012/13 onwards; 3) the more positive than earlier envisaged effect of the weak forint as well as the improving sales mix and cost containment measures on profitability parameters; 4) the less damaging impact of the home regulatory burden, given the steeper fall in sales, as well as of reimbursement levels.

In summary, with the positive impact of the weak forint to be complemented by strict cost control and a less sizable regulatory toll, our net profit target for 2011/12 arrives at HUF 18,675mn, 14.8% up compared to our previous forecast. For 2012/13, although the ongoing domestic price erosion and y/y firming forint will somewhat dampen the y/y progress, with respect to the high 2011/12 base as well as the hit from the regulatory toll being less harmful than originally estimated, we still opt for upward adjustments of our operating and bottom line projections (by 3.9% and 4.1%, respectively).

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Changes in forecast/outlook

Domestic market: 1-3Q11/12 sales down as expected, but outlook for 2012/13 gloomier than anticipated earlier.

The price erosion completely wiped out the positive contribution from new product launches in April-June 2012, the third quarter of Egis' fiscal year 2011/12. In order to maintain reimbursement and defend its competitive position, Egis was forced to cut prices in Hungary by an average of 6.75% from April 1, 2012. (In October 2011, Egis' prices were trimmed 6.9% and in January by an additional 0.6%, on average) As this combined with the effect of the high comparative base, Egis' domestic sales contracted 17.5% y/y to HUF 7,740mn in 3Q11/12, sending the 1-3Q11/12 domestic sales figure to HUF 23,987mn, down 8.7% y/y. Hence, CFO Poroszlai confirmed the earlier guidance for 2011/12, envisaging Egis' domestic sales falling as much as 8-10% y/y. In addition, referring to the permanent pricing pressures, in particular associated with the 'blind bidding' auction process, Egis' CFO became rather skeptical as far as the outlook for 2012/13 is concerned; according to his initial guidance, Egis' domestic sales are anticipated to slip 5-10% y/y during the next fiscal year. Consequently, while 1-3Q11/12 domestic sales matched our forecast and we stick to our target of HUF 31.4bn in sales for 2011/12 (corresponding to a 10% y/y drop), reflecting the newly published 2012/13 guidance, we decided to cut our 2012/13 domestic sales target for Egis to HUF 29.2bn, translating into a 7% y/y decrease (vs. the earlier projected 2% y/y rise). In the medium term, we still envisage Egis' domestic sales recovering and sales advancing some 2.5% p.a., albeit from a lower base.

Buoyed by y/y weaker forint, export sales should back up Egis' top line growth in 2011/12. Although positive impact from currency side will vanish somewhat, strong Russia/CIS, recovery in CEE should bolster export sales growth in 2012/13.

Russia/CIS: While the 3Q11/12 sales rise was tempered due to the relatively high comparative base, Egis' sales progress in Russia (sales up 6.0% y/y) perfectly matched our expectations. On the other hand, the low comparative base (combined with the favorable effect of pre-shipments in Ukraine) played in favor of the y/y progress in Ukraine and other CIS markets, pushing the total Russia/CIS sales figure 4.2% above our forecast in 3Q11/12. CFO Poroszlai fine-tuned the earlier revised 2011/12 guidance to a 6-8% y/y rise for Russia/CIS and a 5-7% increase for Russia (all guidance in euro terms, although in Russia the company switched its invoicing to ruble terms from January 2011). Consequently, we opt to make an adequate adjustment to our full-year 2011/12 projections, now expecting Russian sales to reach EUR 118mn and Russia/CIS sales hitting the EUR 163mn mark. While this is slightly below our previous targets of EUR 123.5mn for Russia and EUR 167.3mn for Russia/CIS, the growth tempo for 2012/13 assumed in the new guidance (10-12% for Russia and Russia/CIS) corresponds to our original assumption (of 11.5%). Hence, while sticking to the growth rate, reflecting the slightly less robust 2011/12 performance, we fine-tune our 2012/13 forecasts for Russia/CIS from around EUR 186.5mn to EUR 181.8mn and for Russia alone from EUR 138.3mn to EUR 131.6mn.

CEE markets: Sales in Eastern Europe slid 2% y/y (to EUR 32.6mn) in 3Q11/12, bringing the 1-3Q11/12 sales of Egis in the CEE region to EUR 89.1mn, down 10.2% y/y. The major reason behind this negative development was the disappointing performance in Poland. The negative impact of changes in the regulatory framework in Poland (which took effect from January 2012), along with unfavorable currency developments (weaker zloty vs. euro), was in the course of 2011/12 more pronounced than we originally envisaged. Consequently, although sales in CEE markets lagged just 0.5% behind our adjusted 3Q11/12 forecast, we are prompted to make a deeper cut into our previous full-year projections. Mirroring the (in the meantime) downward-revised guidance for 2011/12 (from a 5% y/y drop via

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a 10-15% y/y fall to a decrease of 10%), we trim our 2011/12 sales target from EUR 127.2mn to EUR 121mn, corresponding to a 10% y/y decline. The newly published guidance for 2012/13 envisages a return to growth of some 3-6% in euro terms in the CEE region. As we originally assumed the growth tempo here at the lower end of this range (at 3.5% y/y), with respect to the lower starting base, we make only a minor downward correction of our estimates, reducing the CEE sales target for 2012/13 to EUR 125.3mn (vs. the previous EUR 131.6mn).

Western markets: The 2011/12 interim results demonstrated once again the key importance of the orders from Servier on Egis' API sales, as well as the quarterly volatility of the results of this order-driven segment. After the 1Q11/12 bulk chemicals and other sales contraction of 49% y/y, the following quarters brought more solid results and CFO Poroszlai reiterated the guidance, envisaging up to a 5% y/y increase in this sales category for full-year 2011/12. Consequently, we stick to our 2011/12 sales target of around EUR 41.2mn (corresponding to 1% y/y growth). Based on the order flow from Egis' partner Servier, Poroszlai anticipates that bulk sales will advance up to 5% y/y also in 2012/13. Consequently, here we have no reason to change our current 2012/13 estimate of EUR 43.3mn (corresponding to a 5% y/y rise) for this sales category. Also, as sales of finished products, after plummeting 49.2% y/y in 1Q11/12, recovered in the course of the year, the CFO opted to make only a minor adjustment to his original guidance, assuming sales growth closer to the lower end of the earlier indicated range of a 0% to 5% y/y rise. Consequently, we leave our forecast, envisaging 2011/12 sales of finished pharmaceuticals to Western European markets broadly unchanged at some EUR 20mn (corresponding to a 2.5% y/y rise). As for the next fiscal year, the CFO expects a sales acceleration to a 5-10% y/y increase. We opt for a minor upward adjustment of our forecast from EUR 21.0mn to EUR 21.6mn (translating into a rise of 7.5% vs. the earlier expected 4.5%).

After factoring above-mentioned changes into our sales projections, we fine-tune our 2011/12 sales target to around HUF 133bn and see HUF 136.1bn sales target for 2012/13 as achievable.

Finally, we incorporate into our projections newly revised forex assumptions (for 2012, an annual average exchange rate of HUF 230.0/USD, from HUF 236.0/USD, and an annual average exchange rate of HUF 290.0/EUR, from HUF 295.0/EUR). For 2013, we revise our forecast from HUF 224.0/USD to HUF 229.5/USD and from HUF 279.0/EUR to HUF 278.0/EUR. After factoring all of the above-mentioned changes into our sales projections, our 2011/12 sales target arrives at around HUF 133.0bn (marginally changed from the earlier estimated HUF 133.2bn). For 2012/13, reflecting the more subdued than earlier envisaged domestic market sales, compensated for by more robust exports, we set our new sales target at HUF 136.1bn, slightly down (by 3.0%) compared to our previous forecast.

Improving sales mix, weak forint and cost containment measures to offset price erosion, pushing up gross margin in 2011/12. With respect to less supportive forex situation, mild y/y deterioration is in cards for 2012/13.

Buoyed by the positive currency developments and more favorable sales mix, the gross margin improved considerably y/y, from 57.0% in 1-3Q10/11 to 59.0% in 1-3Q11/12, beating our adjusted expectation (of 58.6%). Consequently, although price erosion along with the forint firming will put a lid on the pace of progress in the last quarter of fiscal year 2011/12, we are prompted to increase our gross margin target for 2011/12 quite substantially, from 56.0% to 57.8%. While the domestic pricing pressures will undoubtedly continue to bite into the gross margin, reflecting the positive effect from the improving sales structure (with Russia/CIS sales outpacing the overall sales tempo) as well as cost containment initiatives, our gross margin target for FY12/13 arrives at 56.6%, well above the earlier projected 56.2%.

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Changes to 2011/12 and 2012/13 forecasts

Consolidated, IFRS (HUF, mn)	**2011/12e Now**	**Before**	*Change*	**2012/13e Now**	**Before**	*Change*
Net sales	**132,968**	**133,235**	***-0.2%***	**136,121**	**140,290**	***-3.0%***
Cost of sales	56,109	58,562	*-4.2%*	59,019	61,509	*-4.0%*
Gross profit	**76,859**	**74,673**	***2.9%***	**77,102**	**78,781**	***-2.1%***
Marketing & distr. costs	31,455	31,135	*1.0%*	32,411	32,915	*-1.5%*
Administration costs	10,951	10,990	*-0.4%*	11,144	11,508	*-3.2%*
R&D costs	11,791	12,001	*-1.7%*	12,071	12,605	*-4.2%*
Other oper. exp.	2,702	3,467	*-22.1%*	5,432	6,359	*-14.6%*
Other oper. income	1,251	1,257	*-0.5%*	1,264	1,270	*-0.5%*
Operating profit	**21,211**	**18,338**	***15.7%***	**17,308**	**16,664**	***3.9%***
Financial result	779	1,593	*-51.1%*	1,296	1,638	*-20.9%*
Share of results of associates	-1,007	-1,119	*-10.0%*	-151	-168	*-10.0%*
Pre-tax profit	**20,983**	**18,812**	***11.5%***	**18,453**	**18,135**	***1.8%***
Income taxes	2,308	2,540	*-9.1%*	2,122	2,448	*-13.3%*
Net income	**18,675**	**16,272**	***14.8%***	**16,331**	**15,687**	***4.1%***
Gross margin	57.8%	56.0%		56.6%	56.2%	
EBIT margin	16.0%	13.8%		12.7%	11.9%	
Net margin	14.0%	12.2%		12.0%	11.2%	

Source: Erste Group Research

Except marketing & distribution costs, all operating expenses lagged well behind 1-3Q11/12 sales tempo.

Reflecting expanding activities in Russia/CIS as well as the negative impact of the weakening forint on its export related part of sales & marketing expenses, Egis' sales & marketing costs rose 6.4% y/y in 1-3Q11/12; their share increased to 23.4% of total sales in 1-3Q11/12, up from the year-earlier 22.6%. Consequently, we are prompted to raise our projections here, expecting sales and marketing costs accounting for 23.7% of sales in 2011/12 (vs. the earlier projected 23.4% of sales). As before, we assume that, in 2012/13, sales and marketing expenses will slightly outpace the top line tempo, due in part to preparations for the biosimilars market launch. Although the 1-3Q11/12 data (with a 1.9% drop in the G&A area spending) was slightly more encouraging than we expected, with the traditional accounting for one-off effects coming in 4Q, we opt to leave our forecast for general and administrative costs largely unchanged at around HUF 11bn or 8.2% of sales in 2011/12 and expect them to stay at the same level in relative terms in 2012/13. Although the R&D portfolio rejuvenation keeps its utmost importance as one of the antidotes to the stiffening regulatory measures and spending in this area tends to be uneven, with 1-3Q11/12 R&D expenses down 4.1% y/y, we decided to cut our forecast for 2011/12 by 1.7%, to HUF 11,791mn, or 8.9% of the total sales. Going forward, we continue to assume that the share of R&D costs will be maintained relatively unchanged y/y at around 8.9% of sales in 2012/13.

R&D-based relief to OEP payments bodes well for 2011/12 EBIT.

The change in the Hungarian legislation in December 2011 brought back the possibility of reclaiming the OEP payments, although for only a limited period of time for Hungarian pharma companies, including Egis. Although, the sales tax on reimbursed drug sales was increased to 20% and sales rep fees doubled from July 1, 2011, thanks to the newly available R&D-based relief, the company started to deduct a part of the respective burden from its obligation in 2011/12. Consequently, the total OEP related payments amounted to HUF 2,555mn in 1-3Q11/12, but the deductible amount stood at HUF 2,080mn at the same time, with just the difference showing up in the P&L statement. As the average reimbursement level was lower than originally expected, the final 2011/12 OEP payment bill will be significantly lower than our original estimate. Reflecting in part the latest company guidance, we decrease our estimate here and assume that Egis will record

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Although we do not assume any relief possible in 2012/13, due to lower domestic sales/reimbursement level, pressure on operating profitability margin is expected to ease compared to our previous forecasts.

an expense of some HUF 767mn (down from the earlier estimated HUF 1,108mn) in its fiscal year 2011/12. As before, with no clear word from legislators yet, we expect a return of the full OEP payment obligation to the scene in 2013. However, as domestic sales are now envisaged to be somewhat more subdued in 2012/13 and the reimbursement levels are heading south as well, we reduce our OEP payment related toll forecast from HUF 4,227mn to HUF 3,571mn.

We increase our 2011/12 EBIT margin target 16.0%. Given renewed regulatory toll and firmer forint, 2012/13 will see drop, but this is now seen as less sizable, with 2012/13 EBIT margin projected at 12.7%.

Incorporating the favorable effects of the weak forint (bolstering the gross margin), along with the more profound impact of the R&D-based relief to the OEP payments, our operating margin target for 2011/12 arrives at 16.0%, up from the originally projected 13.8%. We increase our EBIT target for 2011/12 by 15.7% to HUF 21,211mn. Given the still challenging home situation, with pricing pressures and OEP payments in the fully increased amount (i.e. a 20% sales tax, plus doubled sales rep fees), we expect operating profit in 2012/13 to fall. While the company has yet to take a break in its ongoing cost containment efforts, external circumstances (the forint exchange rate, home regulatory burden) are set to hurt more in 2012/13, sending our EBIT target for 2012/13 to HUF 17,308mn, translating into a y/y contraction of the EBIT margin, to 12.7%.

Our net profit target for 2011/12 arrives at HUF 18,675mn, 14.8% up compared to our earlier forecast.

Reflecting the losses at Hungaropharma weighing on Egis' share of its associate's result, the overall 1-3Q11/12 financial result ended in red territory. Nonetheless, while - according to Egis' CFO - the Hungaropharma losses (recorded already in 1Q11/12) represent a one-off, which should not reoccur in the rest of this fiscal year, there is another factor currently working against the achievement of our original full-year 2011/12 forecast of an HUF 474mn financial result balance. The firming of the forint towards the end of the period (calling for the reassessment of the receivables/payables balance) is most likely to have somewhat more negative consequences than we originally estimated. Apart from the forint/EUR, the forint/ruble exchange rate remains the biggest factor here. (As we were informed, the company is hedging 70% of its net forint ruble exposure, while not entering into any new hedging HUF/EUR contracts for the time being.) In order to remain on the conservative side, we opt to decrease our 2011/12 financial result estimate (excluding the share of associates) from HUF 1,593mn to HUF 779mn. Finally, in line with the company's latest guidance, we incorporate into our projections the lower than earlier estimated effective tax rate (cutting it from 13.5% to 11%). All told, our new net profit target arrives at HUF 18,675mn for 2011/12 (vs. the earlier forecast of HUF 16,272mn) and HUF 16,331mn for 2012/13 (vs. the previous target of HUF 15,687mn).

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3Q11/12 results review

Egis announced its 3Q11/12 results on August 6, 2012, after market close. With a tailwind from the weakening forint and enjoying the benefits from the y/y reversing regulatory situation, the bottom line tempo nearly matched the bullish market consensus and surpassed our more conservative forecast.

3Q11/12 results review

Consolidated sales review	3Q11/12	3Q10/11	y/y	1-3Q11/12	1-3Q10/11	y/y
Hungary (HUF mn)	7,740	9,378	*-17.5%*	23,987	26,267	*-8.7%*
Russia (EUR mn)	30.9	29.1	*6.0%*	87.2	83.1	*4.9%*
CIS (EUR mn)	13.1	9.9	*31.8%*	34.0	29.1	*17.0%*
Eastern Europe (EUR mn)	32.6	33.3	*-2.0%*	89.1	99.2	*-10.2%*
Other (EUR mn)	15.1	14.2	*6.1%*	40.4	45.0	*-10.2%*
Total export (EUR mn)	91.6	86.5	*5.9%*	250.7	256.4	*-2.2%*
IFRS consolidated	**3Q11/12**	**3Q10/11**	***y/y***	**1-3Q11/12**	**1-3Q10/11**	***y/y***
Net sales (HUF mn)	34,669	32,377	*7.1%*	98,570	95,866	*2.8%*
Operating profit (HUF mn)	5,939	3,158	*88.1%*	18,336	14,283	*28.4%*
Net income (HUF mn)	5,110	2,310	*121.2%*	16,895	11,525	*46.6%*
Operating margin	*17.1%*	*9.8%*		*18.6%*	*14.9%*	
Net margin	*14.7%*	*7.1%*		*17.1%*	*12.0%*	

Source: Egis

Domestic sales: The mounting pricing pressures, associated in particular with ‘blind bidding auctions’, dragged Egis’ domestic sales down 17.5% y/y (to HUF 7,740mn) in April-June 2012 and sent the 1-3Q11/12 domestic sales figure to HUF 23,987mn, down 8.7% y/y. In order to maintain the reimbursement and market position of its products in Hungary, Egis was forced to reduce its drug prices by 6.75% on average from April 1, 2012.

Exports: Exports amounted to EUR 91.6mn (up 5.9% y/y) in 3Q11/12. With respect to the subdued 1H performance, this still translated into a 2.2% y/y drop in 1-3Q11/12 exports (to EUR 250.7mn). Reflecting the strong comparative base, Egis' sales in **Russia** rose just 6.0% y/y to EUR 30.9mn in 3Q11/12. On the other hand, the low comparative base (combined with the favorable effect of pre-shipments in Ukraine) played in favor of the y/y progress in Ukraine, as well as other CIS markets. Consequently, Egis' sales in **Russia/CIS** advanced a healthy 12.5% y/y to EUR 43.9mn in 3Q11/12 (and grew 8.0% y/y to EUR 121.2mn in 1-3Q11/12). Weighed down by the underperforming Polish market (with sales down 7.6% y/y), plagued by regulatory changes, as well as the weakening of CEE currencies vs. the euro, sales to **Eastern Europe** slipped 2.0% y/y to EUR 32.6mn in 3Q11/12. In 1-3Q11/12, this translated into a 10.2% y/y contraction in Egis’ Eastern European sales, to EUR 89.1mn. As expected, following the 2Q11/12 quarter’s strong showing, the bulk chemicals and others sales retreated 19.2% q/q, while still achieving a modest (2.6%) y/y rise (to EUR 10.0mn) in 3Q11/12. On the other hand, sales of finished pharmaceuticals to other countries kept their momentum, advancing 6.4% q/q and 13.8% y/y to EUR 5.0mn in 3Q11/12. Thus, in total, Egis’ sales to **Western European** markets rose 6.1% y/y to EUR 15.1mn in 3Q11/12 (while still decreasing 10.2% y/y in 1-3Q11/12). According to the company, the favorable changes in the forint exchange rate boosted Egis’ exports some HUF 6.0bn in 1-3Q11/12, out of which HUF 2.5bn was added in 3Q11/12.

Profitability: The positive impact of the favorable currency developments, combined with changes in Egis' sales mix, were only partly compromised by price erosion in its home market. Consequently, the company’s gross margin improved from 58.5% in 3Q10/11 to 59.3% in 3Q11/12. Although Egis' sales and marketing costs as well as G&A costs (hampered by the higher level of provisions) outpaced the sales tempo in 3Q11/12, the operating profit surged 88.1% y/y. The main factor behind it was the y/y improving other income/expense balance. As the company accounted in 3Q11/12 for R&D-based relief to the OEP payments (HUF 953mn allowance, vs. the HUF 860mn payable), the operating margin made a dramatic move, rising to 17.1% in 3Q11/12 (from 9.8% in the year-earlier period, when it was hurt by the renewed OEP payments burden, including the cumulative toll for the previous periods). In 1-3Q11/12, the company's operating margin reached 18.6% and was well above the year-earlier base figure of 14.9%.

Although the forex impact was negative (forex losses of HUF 845mn, out of which HUF 239mn was realized) and the 3Q11/12 financial result switched into red territory, ending at a loss of HUF 355mn (compared to a financial profit of HUF 109mn in 3Q10/11), the share of results of associated companies turned positive this time (from an HUF 505mn loss in 3Q10/11 to a profit of HUF 45mn in 3Q11/12). Consequently, bolstered further by the y/y decreasing effective tax rate, 3Q11/12 net profit skyrocketed (up 121.2% y/y).

Valuation /Recommendation

We adjust our DCF model parameters to include decreasing government bond yields.

Compared to other core CEE countries, macroeconomic conditions in Hungary continue to be more challenging (mirrored in government bond yields staying well above their CEE-based counterparts'), although recently the situation seems to have calmed down a bit, with the IMF / EU deal conclusion getting closer on the horizon. While some uncertainties remain, nonetheless, Hungarian government bond yields have taken a downward trajectory, prompting us to lower the risk-free rate from 8.6% to 7.5% for the detailed forecast period of 2013-17. With no change in the country's rating since our last report in March 2012, we stick to the earlier applied equity risk premium of 7.15% for the forecast period of 2013-17 and 6.65% for perpetuity yields. Consequently, we derive a WACC of 13.4% for 2013-17 and 11.6% for perpetuity, compared to the 14.5% and 11.6%, respectively, used in our previous valuation. After incorporating all of the above-mentioned changes to our forecasts into our DCF model (as well as a new timeframe), our DCF-derived 12-month target price arrives at HUF 22,850 per share, 11.7% above our earlier target price of HUF 20,455.

Our 12-month target price of HUF 22,850 per share points to still attractive upside potential for stock, despite its recent appreciation.

Egis' 1-3Q11/12 results were well ahead of original expectations, with most market participants (including us) worried about the deteriorating sales outlook both at home as well as in the CEE region, particularly in Poland. Although (as before) there is no doubt that the company's relatively high home market exposure (despite a 8.7% y/y sales drop, Hungary's share stood at 24.3% of sales in 1-3Q11/12) represents a disadvantage compared to its peers, enjoying a boost from the weak forint and solid progress in Russia/CIS sales, complemented by efficient cost control, the company is on right path to post record-breaking results in 2011/12.

Although the quarterly price cut as of April 2012 was significantly more sizable than the market anticipated, and the company's pessimistic guidance for 2012/13 indicated that that domestic market recovery might take longer than originally thought, we believe that the company is in better shape and is better equipped to cope with the pressure than it was back in

2007, when the austerity measures first hit the pharma market in Hungary. Not only has Egis advanced in its generics portfolio rejuvenation (with new products typically offering higher prices and margins), the company also initiated cost efficiency enhancement programs, with already palpable results on both the gross and operating profitability levels.

The Celltrion cooperation is advancing nicely, leaving no doubts that it will yield tangible results soon.

While Egis opted not to tap opportunities in the newly opening area of biosimilars on its own, the Celltrion cooperation is advancing nicely, leaving no doubts that it will yield tangible results soon. In March 2012, Egis' partner Celltrion already submitted an application for marketing authorization for its biosimilar infliximab (as for the first biosimilar monoclonal antibody) to the European Medicine Agency (EMA). Furthermore, Celltrion announced the positive results of clinical studies of biosimilar infliximab product at the Annual Congress of the European League against Rheumatism (EULAR) in Berlin in June 2012. Celltrion's biosimilar infliximab demonstrated equivalence with the original product *Remicade* (Merck&Co and J&J; combined global sales amounting to USD 8.2bn in 2011) in pharmacokinetics, safety and efficacy in treatment of ankylosing spondylitis in a phase I study and it proved to be equivalent with *Remicade* in a phase III study when co-administered with methotrexate in patients with active rheumatoid arthritis. According to the contract, Egis will have exclusive rights to market eight biosimilar products from the Celltrion portfolio in five countries of the CIS region (including Russia) and semi-exclusive rights in an additional 12 countries in the CEE region. Although the names of the products were not publicly disclosed, a biosimilar to *Remicade* as well as biosimilars to other bestselling products, such as Roche's *Herceptin*, are anticipated to top the list of products under cooperation. Recently, Egis confirmed that it expects the first product within the frame of the cooperation contract with Celltrion to be launched in 2012/13 (to post some EUR 30mn in sales in 2014).

Furthermore, Egis' news flow might provide even more catalysts in the coming period, as suggested by Egis' plans to supply Watson with rosuvastatin zinc product to compete with AstraZeneca's *Crestor*. As the product launch is still subject to the outcome of a pending lawsuit (with the earliest possible launch at risk for Watson foreseen in April 2013), Egis hesitates to provide any information on the possible date for commercial launch or expected sales revenues of the product. Consequently, while at the current stage it is still difficult to properly assess the impact of rosuvastatin zinc product on Egis' valuation, the news flow here could be viewed as positive, as Egis has in this case nothing to lose, while the possible contribution to the top line will be, in our opinion, in the range of several dozens of millions of USD as peak sales.

Last but not least, a brief look at its balance sheet confirms that Egis is in very healthy shape, with practically no external debt and a huge cash pile (of HUF 32.1bn at the end of June 2012), adding more arguments for Egis' solid defensive case.

We confirm our Buy recommendation.

All told, although the home pharma (as well as some CEE regional) market outlook is gloomy at the moment and the company's home currency cushion is set to get thinner in the coming periods, we believe that these negatives are more than adequately priced in. At the same time, Egis' growth story is gaining momentum, with new potential triggers adding to the traditionally sound fundamental position of the company. Despite the recent stock rally, the valuation multiples remain attractive and the valuation gap still wide, warranting our Buy recommendation on the stock.

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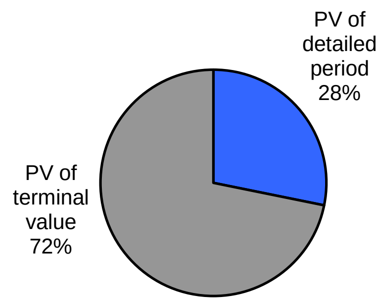
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	7.5%	7.5%	7.5%	7.5%	7.5%	5.0%
Equity risk premium	7.15%	7.15%	7.15%	7.15%	7.15%	6.65%
Beta	0.84	0.84	0.84	0.84	0.84	1.0
Cost of equity	**13.5%**	**13.5%**	**13.5%**	**13.5%**	**13.5%**	**11.7%**
Cost of debt	8.0%	8.0%	8.0%	8.0%	8.0%	5.5%
Effective tax rate	11.5%	11.5%	11.5%	11.5%	11.5%	19.0%
After-tax cost of debt	**7.1%**	**7.1%**	**7.1%**	**7.1%**	**7.1%**	**4.5%**
Equity weight	99%	99%	99%	99%	99%	99%
WACC	**13.4%**	**13.4%**	**13.4%**	**13.4%**	**13.4%**	**11.6%**

DCF valuation

(HUF mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Sales growth	*2.4%*	*7.2%*	*7.9%*	*8.1%*	*9.0%*	*6.0%*
EBIT	17,308.3	18,739.7	20,957.1	23,448.9	26,471.0	23,594.8
EBIT margin	*12.7%*	*12.8%*	*13.3%*	*13.8%*	*14.3%*	*12.0%*
Tax rate	*11.5%*	*11.5%*	*11.5%*	*11.5%*	*11.5%*	*19.0%*
Taxes on EBIT	-1,990.4	-2,155.1	-2,410.1	-2,696.6	-3,044.2	-4,483.0
NOPLAT	**15,317.8**	**16,584.6**	**18,547.0**	**20,752.2**	**23,426.9**	**19,111.8**
+ Depreciation	10,665.3	11,342.2	12,070.4	12,848.3	13,679.5	13,679.5
Capital expenditures / Depreciation	*150.8%*	*149.3%*	*147.6%*	*145.9%*	*144.2%*	*100.0%*
+/- Change in working capital	-949.1	-2,720.1	-3,211.6	-3,487.0	-4,135.6	-3,171.9
Chg. working capital / chg. Sales	*-30.1%*	*-27.9%*	*-27.8%*	*-27.2%*	*-27.1%*	*-28.5%*
- Capital expenditures	-16,083.8	-16,938.0	-17,816.3	-18,746.7	-19,722.9	-13,679.5
Free cash flow to the firm	**8,950.1**	**8,268.8**	**9,589.5**	**11,366.9**	**13,247.8**	**15,939.8**
Terminal value growth						*2.0%*
Terminal value						169,878.4
Discounted free cash flow - September 30 2(	7,891.3	6,428.0	6,572.8	6,869.3	7,058.9	88,741.8
Enterprise value - September 30 2012	**123,562.1**					
Minorities	0.0					
Non-operating assets	0.0					
Net debt	-33,175.2					
Other adjustments	0.0					
Equity value - September 30 2012	**156,737.3**					
Number of shares outstanding (mn)	7.8					
Cost of equity	13.5%					
12M target price per share (HUF)	22,850					
Current share price (HUF)	17,300					
Up/Downside	*32.1%*					

Enterprise value breakdown



Source: Erste Group Research

Sensitivity (per share)

WACC	Terminal value EBIT margin 11.0%	11.5%	12.0%	12.5%	13.0%
10.6%	22,916	23,638	24,360	25,082	25,803
11.1%	22,200	22,882	23,564	24,246	24,927
11.6%	21,558	22,204	**22,850**	23,497	24,143
12.1%	20,980	21,594	22,208	22,822	23,437
12.6%	20,456	21,041	21,627	22,212	22,797

WACC	Terminal value growth 1.0%	1.5%	2.0%	2.5%	3.0%
10.6%	22,850	23,564	24,360	25,255	26,268
11.1%	22,208	22,850	23,564	24,360	25,255
11.6%	21,627	22,208	**22,850**	23,564	24,360
12.1%	21,097	21,627	22,208	22,850	23,564
12.6%	20,614	21,097	21,627	22,208	22,850

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Income Statement (IAS, HUF mn, 30/09)	**2009** 30/09/2009	**2010** 30/09/2010	**2011** 30/09/2011	**2012e** 30/09/2012	**2013e** 30/09/2013	**2014e** 30/09/2014
Net sales	**116,142.00**	**118,915.00**	**128,939.00**	**132,967.87**	**136,121.23**	**145,887.79**
Cost of goods sold	-51,792.00	-52,206.00	-56,833.00	-56,109.16	-59,019.39	-63,095.84
Gross profit	**64,350.00**	**66,709.00**	**72,106.00**	**76,858.72**	**77,101.84**	**82,791.96**
SG&A	-37,515.00	-38,169.00	-40,511.00	-42,406.59	-43,554.32	-46,880.10
Other operating revenues	1,397.00	1,003.00	1,245.00	1,251.23	1,263.74	1,276.37
Other operating expenses	-12,693.00	-12,385.00	-16,538.00	-14,492.79	-17,503.00	-18,448.54
EBITDA	**23,350.00**	**25,455.00**	**25,609.00**	**31,250.45**	**27,973.51**	**30,081.94**
Depreciation/amortization	-7,811.00	-8,297.00	-9,307.00	-10,039.89	-10,665.25	-11,342.25
EBIT	**15,539.00**	**17,158.00**	**16,302.00**	**21,210.56**	**17,308.26**	**18,739.69**
Financial result	485.00	2,243.00	-626.00	-227.95	1,144.90	1,544.44
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**16,024.00**	**19,401.00**	**15,676.00**	**20,982.61**	**18,453.16**	**20,284.13**
Income taxes	-2,273.00	-2,618.00	-2,091.00	-2,308.09	-2,122.11	-2,332.67
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	0.00	0.00	0.00	0.00	0.00	0.00
Net result after minorities	**13,751.00**	**16,783.00**	**13,585.00**	**18,674.52**	**16,331.05**	**17,951.45**

Balance Sheet (IAS, HUF mn, 30/09)	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Intangible assets	4,286.00	4,089.00	4,101.00	4,201.00	4,301.00	4,408.53
Tangible assets	57,189.00	63,508.00	69,347.00	73,251.87	77,590.31	82,026.60
Financial assets	7,943.00	7,431.00	5,055.00	5,181.38	5,310.91	5,443.68
Total fixed assets	**69,418.00**	**75,028.00**	**78,503.00**	**82,634.25**	**87,202.22**	**91,878.81**
Inventories	38,957.00	38,768.00	35,836.00	36,586.19	36,985.66	38,311.43
Receivables and other current assets	26,457.00	42,773.00	51,121.00	52,373.03	52,999.09	55,682.21
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	23,238.00	17,973.00	25,260.00	36,208.31	45,152.30	53,768.55
Total current assets	**88,652.00**	**99,514.00**	**112,217.00**	**125,167.53**	**135,137.05**	**147,762.19**
TOTAL ASSETS	**158,070.00**	**174,542.00**	**190,720.00**	**207,801.78**	**222,339.27**	**239,641.00**
Shareholders'equity	**132,756.72**	**149,121.72**	**161,638.72**	**179,378.95**	**194,775.71**	**211,792.88**
Minorities	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
LT provisions	**2,103.00**	**1,216.00**	**1,244.00**	**1,368.40**	**1,436.82**	**1,508.66**
Interest-bearing LT debts	3,029.00	2,989.00	3,017.00	2,866.15	2,794.50	2,724.63
Other LT liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Total long-term liabilities	**3,029.00**	**2,989.00**	**3,017.00**	**2,866.15**	**2,794.50**	**2,724.63**
Interest-bearing ST debts	111.00	221.00	159.00	166.95	176.97	190.24
Other ST liabilities	20,070.29	20,994.29	24,661.29	24,021.33	23,155.27	23,424.58
Total short-term liabilities	**15,415.00**	**14,308.00**	**15,400.00**	**15,884.18**	**16,266.93**	**17,434.64**
TOTAL LIAB. , EQUITY	**158,070.00**	**174,542.00**	**190,720.00**	**207,801.78**	**222,339.27**	**239,641.00**

Cash Flow Statement (IAS,HUF mn, 30/09)	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Cash flow from operating activities	21,113.00	12,948.00	25,027.00	27,247.05	26,047.19	26,573.56
Cash flow from investing activities	-1,289.00	-17,191.00	-16,534.00	-15,279.30	-16,083.85	-16,937.96
Cash flow from financing activities	-1,324.00	-1,022.00	-1,206.00	-1,019.44	-1,019.36	-1,019.36
CHANGE IN CASH , CASH EQU.	**18,500.00**	**-5,265.00**	**7,287.00**	**10,948.31**	**8,943.99**	**8,616.25**

Margins & Ratios	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Sales growth	6.4%	2.4%	8.4%	3.1%	2.4%	7.2%
EBITDA margin	20.1%	21.4%	19.9%	23.5%	20.6%	20.6%
EBIT margin	13.4%	14.4%	12.6%	16.0%	12.7%	12.8%
Net profit margin	11.8%	14.1%	10.5%	14.0%	12.0%	12.3%
ROE	10.9%	11.9%	8.7%	11.0%	8.7%	8.8%
ROCE	10.6%	12.4%	8.9%	12.0%	9.9%	10.4%
Equity ratio	84.0%	85.4%	84.8%	86.3%	87.6%	88.4%
Net debt	-20,098.0	-14,763.0	-22,084.0	-33,175.2	-42,180.8	-50,853.7
Working capital	73,237.0	85,206.0	96,817.0	109,283.4	118,870.1	130,327.5
Capital employed	114,761.7	135,574.7	140,798.7	147,572.1	154,031.7	162,447.9
Inventory turnover	1.4	1.3	1.5	1.5	1.6	1.7

Source: Company data, Erste Group estimates

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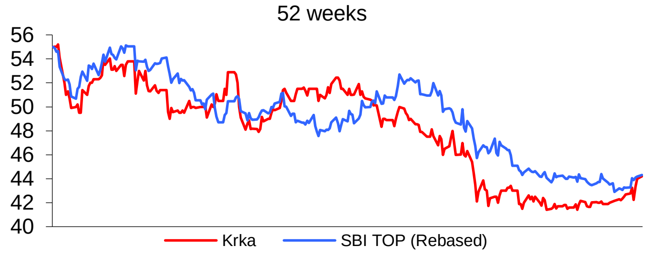
ERSTE GROUP

Krka

Buy

EUR mn	2011	2012e	2013e	2014e
Net sales	1,075.6	1,146.0	1,228.2	1,322.2
EBITDA	301.2	330.4	360.5	393.5
EBIT	214.0	234.5	254.1	275.4
Net result after min.	162.8	175.0	193.3	212.8
EPS (EUR)	4.60	4.94	5.46	6.01
CEPS (EUR)	6.94	7.35	8.20	9.10
BVPS (EUR)	32.13	35.67	39.68	44.13
Div./share (EUR)	1.45	1.55	1.65	1.80
EV/EBITDA (x)	6.4	4.9	4.4	4.0
P/E (x)	11.5	8.9	8.1	7.4
P/CE (x)	7.6	6.0	5.4	4.9
Dividend Yield	2.7%	3.5%	3.7%	4.1%

Share price (EUR) close as of 10/09/2012	44.2
Number of shares (mn)	35.4
Market capitalization (EUR mn)	1,566.2
Enterprise value (EUR mn)	1,608.7



Performance	12M	6M	3M	1M
in EUR	-22.4%	-14.2%	4.4%	5.2%

Reuters	KRKG.LJ	Free float	68.6%
Bloomberg	KRKG SV	Shareholders	SOD Fund (15.0%)
Div. Ex-date	10/07/12		KAD (9.86%)
Target price	**69.5**	Homepage:	www.krka.si

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Well on track to meet 2012 targets

The 1H12 results confirmed that Krka is well on track to meet or even surpass its guidance. With valuation parameters only slightly compromised, following Slovenia's S&P rating downgrade, our DCF-derived 12-month target price arrives at EUR 69.5 per share (vs. the earlier target of EUR 73.5). Thanks to its well-balanced sales structure, R&D pipeline rich in generic equivalents to global bestsellers coming out of patent, as well as efficient cost control, the company retains its regional competitive edge. Should the market situation improve, the company is committed to take the next steps in the Warsaw listing, with the offering of its treasury shares to institutional investors promising to improve its liquidity and visibility on the international scene. All told, we confirm our Buy recommendation.

The changes to our model focus on incorporating 1) the depressed CEE markets' tempo, plagued by austerity measures; 2) the more robust than envisaged performance in Russia/CIS; 3) the more sizable spending in the sales & marketing cost area, driven in part by the increasing regulatory toll in the CEE region; 3) the somewhat more damaging impact of the regional currencies' weakening on the financial result; and 4) the decreasing effective tax rate in 2012 and in the coming years.

All told, while fine-tuning our sales assumptions per territory, we stick to our sales target for 2012 at EUR 1,146.0mn. With a hike in sales & marketing costs compensated for by strict cost control in the G&A area, we leave our 2012 operating profit target broadly unchanged at EUR 234.5mn. Despite the regional currencies' recent embarkation on a firming path, with respect to the weak 1H, we now expect the financial result to end deeper in the red. Nonetheless, as this will be offset by a decreasing tax rate, we still see our net profit target for 2012 of EUR 175.0mn as achievable.

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Changes in forecast/outlook

1H12 report confirmed earlier revealed sales highlights.

CEE markets: The 1H12 results provided more compelling evidence of the difficulties Krka is coping with in its traditional stronghold in Central European markets. The negative consequences of the ongoing healthcare reforms were magnified by its status as the only Euro Area-based pharma player, as its Hungarian peers' suffering was to a certain extent lessened, due to their home currency's being on a similar depreciation path vs. the euro in 1H12. While the latest forex developments are encouraging for Krka and point to an easing currency grip for the Slovene company in 2H12, the tightening of reimbursement rules and price erosion continue to darken the outlook. According to Krka's management, the worst seems to be over in the crucial Polish market, and the company's sales started to recover there. However, with Krka's 1H12 sales performance lagging behind our original expectations, we are forced to make another cut to our 2012 forecast for sales in the CEE region from EUR 296.9mn to EUR 285.3mn (translating into a 1% y/y drop). For 2013, we continue to assume only a gradual revival; while we are sticking to a 4.5% y/y rise, with respect to the lower base, this translates into a new sales target of EUR 298.2mn, 4% below our previous estimate.

While we believe that our overall full-year sales target is within reach, we opt to fine-tune our projections, to more accurately mirror interim sales data and trends in Krka's key markets.

Southeast Europe: The 1H12 sales report confirmed that Krka's sales tempo in SEE markets will be tempered this year, witnessing the negative impact of the cost savings measures as well as persisting problems with receivables collection in the Romanian market, the largest one in this sales category. In 1H12, Krka's sales in SEE markets were flat, indicating that our original forecast of a 5.8% y/y rise might be slightly too optimistic. Nevertheless, taking into account the 2Q acceleration (with sales up 4.6% y/y and 8.9% q/q), we opt for only a minor downward fine-tuning of our full-year projections, trimming our sales target from EUR 154.6mn to EUR 152.0mn, corresponding to a 4% y/y rise. For 2013, we see the y/y pace staying around the same level and set a new sales target at EUR 158.1mn.

Russia/CIS: After their tempo accelerated to 31.7% y/y in 2Q, Krka's Russia/CIS sales advanced a hefty 24.8% y/y in 1H12 to EUR 167.9mn, well above our original forecast. The excellent showing in Russia alone, with sales of EUR 114.9mn (up 24% y/y), was one of the major reasons for the outperformance. In addition, the sales progress in Ukraine and other CIS markets was also impressive. The solid ruble position and steadily high oil prices continue to support a sound macroeconomic picture, boding well for Krka's sales improvements in the Russian market in the coming periods. Consequently, we are prompted to raise our target for Krka's 2012 sales in Russia/CIS from EUR 310.9mn, corresponding to a 9% sales growth tempo, to EUR 329.4mn, or 15.5% y/y expansion. For 2013, we expect Russia/CIS sales to maintain their dynamism and set a new sales target at EUR 362.4mn, up 10% y/y (and 6.5% above our previous forecast of EUR 340.4mn).

Western Europe: The 1H12 results confirmed that sales in Western Europe and Overseas markets are maintaining their momentum. Driven by new product launches, sales growth in Western markets reached 23.1% y/y in 1H12 (following the 21.8% y/y tempo recorded in 2011). As a result, we feel comfortable with our original forecast for 2012, envisaging Krka's sales in this category amounting to EUR 279.6mn (up 10% y/y). Going forward, we believe that, further supported by the sales network expansion and new product introductions, Krka's sales in Western Europe will remain robust.

For 2013, we leave our projections broadly unchanged and expect Krka's Western European sales to advance 10% y/y to EUR 307.6mn.

We leave our sales target for 2012 of EUR 1,146mn intact, translating into a 6.5% y/y rise.

In summary, while we adjust our forecasts in order to reflect the actual 1H12 sales figures more adequately, we leave our sales target for 2012 of EUR 1,146mn intact, translating into a 6.5% y/y rise (a notch above the company's current guidance of sales of EUR 1,134mn). Although we still think that Krka has all prerequisites to return to a double-digit top line growth pace in the coming years, given the regulatory pressures in the CEE markets, we stick for the time being to a more cautious stance in the near term and envisage the sales growth rate remaining somewhat below that mark (at 6.5% in 2012 and 7.2% y/y in 2013).

Despite pricing pressures, gross profitability margin set to remain solid.

The unfavorable forex developments (with most of the CEE currencies depreciating vs. the euro) magnified the negative impact of the tightening regulatory situation, particularly in the CEE region, sending Krka's gross margin from 62.2% in 1H11 to 61.1% in 1H12. Due in part to the robust performance in high-margin Russia/CIS, the gross margin was slightly above our expectations for the period. However, with respect to the ongoing pricing pressures in the CEE region (only partly compensated for by the anticipated easing regional currencies' grip), we opt for a more cautious stance and reduce our gross margin forecast to 61.3% (vs. the earlier projected 61.5%) for 2012. Going forward, we envisage these trends continuing, with the positive effect on Krka's gross profitability stemming from changes in the product and territorial sales structure to be largely wiped out by the price erosion in CEE markets. Nonetheless, factoring in the more beneficial forex impact, we assume a slight improvement in the 2013 gross margin to 61.5% (slightly below our previous target of 61.8%).

As more sizable sales & marketing spending (lifted by regional regulatory toll) is offset by savings in G&A area, we stick to our 2012 EBIT margin target of 20.5%.

Accelerating 11.9% q/q, sales and marketing costs advanced 13.9% y/y in 1H12, to account for 26.0% of the total sales and surpass our forecast by some 3%. The relatively high tempo was driven not only by further expansion of the sales and marketing network and necessary support of new product launches, but also by the escalating regulatory burden (clawback in Romania, OEP payments in Hungary). Consequently, we are prompted to make another upward adjustment of our sales and marketing cost estimate and envisage these expenses accounting for around 26% of total 2012 sales (above the earlier estimated 25.8% of sales). For 2013, we continue to expect sales and marketing cost growth returning to match the sales tempo, and hence their relative share unchanged compared to the 2012 level. On the other hand, it was encouraging to see that, in 1H12, the company kept other operating expenses well under control. While the spending in the G&A area tends to be volatile on a quarterly basis (depending in part on the timing of bonus payments), in 1H12, the company managed to trim general and administrative costs 5.4% y/y (to EUR 35.1mn, or 6.9% below our estimate). Although we think that, after the relatively sizable cost cutting move in 2011, the room for savings will be narrower this year, we opt to cut our G&A expense forecast to 75.7mn, or 6.6% of total 2012 sales. For 2013, we anticipate that the company will not take a break in its cost containment efforts, and project the share of G&A costs decreasing to around 6.5% of total sales. Furthermore, in 1H12, Krka's R&D expenditures lagged 2.6% behind our forecasts. While this was to a certain extent undoubtedly attributable to the traditionally uneven quarterly spending in this field, and Krka remains committed to investing in the R&D area as the main source of its future growth, we nevertheless opt to make a minor downward fine-tuning of our forecasts here, lowering the envisaged share of R&D expenses in total sales from the average level of 8.9-9.0% to 8.8-8.9% in 2012 and 2013.

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Changes to 2012 and 2013 forecasts

Consolidated, IFRS (EUR, mn)	2012e Now	2012e Before	2012e Change	2013e Now	2013e Before	2013e Change
Net sales	**1,146.0**	**1,146.0**	***0.0%***	**1,228.2**	**1,231.8**	***-0.3%***
Costs of goods sold	443.3	441.8	*0.3%*	473.0	470.1	*0.6%*
Gross profit	**702.7**	**704.3**	***-0.2%***	**755.2**	**761.7**	***-0.8%***
Sales & marketing exp.	297.6	296.1	*0.5%*	318.9	318.3	*0.2%*
R&D expenses	101.2	101.4	*-0.2%*	109.3	110.2	*-0.8%*
General & admin. exp.	75.7	77.9	*-2.8%*	80.3	82.5	*-2.7%*
Other oper. income	6.4	6.4	*0.0%*	7.4	7.4	*-0.3%*
Operating profit	**234.5**	**235.2**	***-0.3%***	**254.1**	**258.1**	***-1.5%***
Financial result	-13.1	-8.0	*62.4%*	-11.0	-6.6	*66.5%*
Income taxes	46.5	52.3	*-11.0%*	49.8	57.8	*-13.8%*
Minorities	-0.1	-0.1	*0.0%*	-0.1	-0.1	*0.0%*
Net income	**175.0**	**175.0**	***0.0%***	**193.3**	**193.7**	***-0.2%***
Gross margin	61.3%	61.5%		61.5%	61.8%	
EBIT margin	20.5%	20.5%		20.7%	21.0%	
Net margin	15.3%	15.3%		15.7%	15.7%	

Source: Erste Group Research

In summary, our 2012 EBIT target is nearly unchanged at EUR 234.5mn.

Given the numerous litigations pending, as well as the lack of visibility on their timing, the levels of necessary new provisioning and the release of previous provisions have traditionally been among the biggest question marks in forecasting Krka's results. After a bumpy 2009, when the total reversal of provisioning (recorded under other operating income) stood at a record high of EUR 91.4mn, while additional provisions (weighing on sales and distribution expenses) totaled EUR 47.5mn, neither 2010 nor 2011 saw any major events in this respect. Although the company believes that it did not violate any of the EU anti-trust laws and that the provisions of EUR 47.5mn created for the perindopril case will possibly be reversed at some point in the future, this is not envisaged to happen in the near future. Consequently, we continue to assume a low level of provision release this year. At the same time, we also envisage that there is no major litigation on the horizon and hence the level of provisioning should remain at a minimal level in 2012. As a result, for the time being, we stick to our forecast for the other operating income balance at around EUR 6.4mn in 2012 and EUR 7.4mn in 2013. In summary, our 2012 EBIT target is practically unchanged at EUR 234.5mn, corresponding to an EBIT margin of 20.5%. For 2013, we still think that a slight improvement of the operating margin is within reach and set our EBIT target at EUR 254.1mn, translating into an EBIT margin of 20.7%.

The first six months of 2012 provided compelling evidence of the increased volatility of the regional currencies and its relatively profound impact on Krka's financial result. In total, in 1H12, following a switch in 2Q12 (with a loss of EUR 13.6mn, vs. a 1Q12 gain of EUR 5.1mn), the financial result was significantly worse than we expected (at a EUR 8.5mn loss, vs. our forecast of a EUR 1.1mn gain). The major reason behind the disappointing outcome was the swinging regional currencies' fortunes and associated forex balance (turning from a EUR 10.3mn gain in 1Q12 to a loss of EUR 11.5mn in 2Q12). In addition, the company's 1H12 financial result was hampered not only by forex losses, but also once again by provisioning for bad receivables. Nonetheless, at least the total impairment and write-off of receivables of EUR 2.2mn were somewhat below the year-earlier level of EUR 5mn and the company emphasized that currently it does not envisage any need for additional provisioning or write-offs. The company also

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confirmed that, after rather unfortunate hedging activities in 1Q12 intended to protect it from potential weakening of the ruble (ending at a loss of EUR 4.9mn), it did not enter into any new contracts and aims not to do so for the rest of the year. Although we continue to believe that, bolstered by the 2H12 turn for the better, the unfavorable forex result will hurt Krka less this year than in 2011, we are forced to make downward adjustments to our full-year 2012 financial result projections. We now anticipate Krka's 2012 financial result ending at a loss of EUR 13.1mn (vs. the earlier projected loss of EUR 8.0mn). Going forward, we opt for a more conservative stance and we adjust our estimate for the 2013 financial result to a EUR 11.0mn loss (compared to our previous forecast of a EUR 6.6mn loss).

With slightly worse financial result to be offset by lower effective tax rate, our net profit target for 2012 remains at EUR 175.0mn.

Last but not least, we factor in the favorable changes in Krka's home market's tax legislation. In 1H12, the effective tax rate decreased to 17.0% (down from the 22.0% recorded in 1H11). The outlook remains bright after the Parliament approved changes to the corporate tax law in Slovenia. Not only will the statutory corporate tax rate be lowered gradually to 15% by 2015, with the rate of 18% to be applied already for 2012, but the amount of the deductible allowances related to R&D and other investments will not be strictly limited in absolute terms, as it used to be in the past. Consequently, we are prompted to make adequate changes to our projections, reducing the effective tax rate assumption to 21% for 2012, 20.5% for 2013 and 20% from 2014 onwards. In summary, our net profit target for 2012 arrives at EUR 175.0mn, virtually unchanged from our previous estimate. For 2013, we assume that, backed by solid top line growth and strict cost control, as well as bolstered by more favorable forex developments (visible in the gross margin as well as in the improving financial result), Krka has all prerequisites to notch a healthy bottom line tempo. We set our new 2013 consolidated net profit target at EUR 193.3mn, corresponding to a 10.5% y/y increase.

1H12 results review

Krka published its 1H12 report on July 26, 2012, kicking off the reporting season in the CEE pharma universe.

1H12 results review

Consolidated sales review

EUR 000	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Slovenia	24,058	27,524	-12.6%	46,974	51,629	-9.0%
South-East Europe	38,503	36,811	4.6%	73,846	73,545	0.4%
Russia/CIS	89,309	67,798	31.7%	167,941	134,580	24.8%
Central Europe	71,872	79,419	-9.5%	137,903	156,440	-11.8%
Western Europe & Overseas	68,004	59,297	14.7%	138,628	112,611	23.1%
IFRS consolidated	**2Q2012**	**2Q2011**	***y/y***	**1H2012**	**1H2011**	***y/y***
Total sales (EUR 000)	291,746	270,849	*7.7%*	565,292	528,805	*6.9%*
Operating profit (EUR 000)	62,298	62,357	*-0.1%*	117,055	123,247	*-5.0%*
Net income (EUR 000)	41,425	44,480	*-6.9%*	90,066	92,441	*-2.6%*
Operating margin	*21.4%*	*23.0%*		*20.7%*	*23.3%*	
Net margin	*14.2%*	*16.4%*		*15.9%*	*17.5%*	

Source: Krka

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With strong Russia/CIS and Western European markets sales offsetting CEE weakness, 1H12 sales advanced 6.9% y/y to EUR 565.3mn, fully confirming earlier published sales highlights.

As Krka published its key 1H12 sales performance data earlier in July, the full 1H12 report did not bring any major surprises as far as the top line is concerned. In 1H12, the top line was reported to have advanced 6.9% y/y to EUR 565.3mn, out of which the second quarter delivered EUR 291.7mn (up 7.7% y/y). Exports accounted for 91.7% of total consolidated sales in 1H12.

As already indicated by previous interim results, Krka's well established presence in Russia/CIS represents a strong card to play this year. In 1H12, Krka's sales in Russia/CIS surged 24.8% y/y to EUR 167.9mn to account for 29.7% of the total consolidated sales figure. In Russia alone, Krka's 1H12 sales tempo was at an excellent 24% y/y, with sales reaching EUR 114.9mn. Krka also did well in Ukraine, where its sales expanded y/y by one quarter to EUR 27mn. Furthermore, with a tailwind from new product launches, sales in Western Europe and overseas markets rose a robust 23.1% y/y to EUR 138.6mn. On the other hand, domestic sales contracted 9% y/y, and Slovenia decreased to just an 8.3% share of Krka's total consolidated sales in 1H12. In addition, as expected, dragged down by the y/y worsening situation in Poland and Hungary, Krka's CEE sales shrank 11.8% y/y to EUR 137.9mn in 1H12. Krka's sales in Poland, the largest of its CEE markets, slumped 17% y/y to EUR 55.4mn during this period. Last but not least, sales in South-East Europe were practically flat y/y, at EUR 73.8mn.

CEE region's woes, reflected in price erosion, coupled with 2Q deteriorating currency fortunes, sent Krka's bottom line down 2.6% y/y in 1H12.

Weighed down by the ongoing pricing pressures, particularly in the CEE region, Krka's gross margin slightly worsened y/y, from 62.2% in 1H11 to 61.1% in 1H12. Rising 13.9% y/y, sales and marketing costs outpaced the sales tempo, due in part to the increasing regulatory burden in the CEE region (Hungary, Romania). On the other hand, the company kept its administrative expenses well under control, trimming them 5.4% y/y in 1H12. Following the y/y deterioration in 1Q (with EBIT down 10.1% y/y), 2Q provided a somewhat more optimistic picture, with EBIT up 13.8% q/q, and down just 0.1% y/y. Consequently, the operating profit decline was reduced to 5.0% y/y in 1H12, with EBIT totaling EUR 117.1mn.

The q/q significantly less favorable forex situation (with forex-linked losses excluding the hedging outcome amounting to EUR 1.2mn in 1H12 and EUR 11.5mn in 2Q12 alone), along with the new impairments and write-offs of receivables (amounting to EUR 2.2mn in 1H12, out of which EUR 2.0mn was added in 2Q12), put a brake on the bottom line tempo in 1H12. (For comparison, in 1H11, the forex result was at a positive EUR 0.5mn, while impairments and write-offs stood at a relatively more sizable EUR 5mn.) Consequently, despite the help from the y/y decreasing effective tax rate (from 22.0% in 1H11 to 17.0% in 1H12), net profit slid 2.6% y/y in 1H12 (and 6.9% y/y in 2Q12).

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Valuation / Recommendation

Despite recent deterioration, its home country status still warrants relative advantage for Krka's valuation compared to its peers.

With its home country Slovenia not sheltered from the consequences of the deepening Eurozone crisis, Krka's valuation model parameters deteriorated as of lately. First, reflecting the mounting impact of the crisis on Slovenia's small and open economy, Slovene government bond yields climbed, prompting us to make an adequate adjustment of our risk-free rate assumptions in our DCF model for Krka, from 5.5% to 6.6% for 2013-17. (For perpetuity, we continue to apply a risk-free rate of 5%.) Secondly, our methodology for setting equity risk premiums is linked to the country's S&P long-term currency rating. Here, although Slovenia keeps its status as one of the top performers in the CEE region, it suffered a new downgrade recently (from an A+ to A rating). Consequently, our methodology now yields an equity risk premium for the explicitly forecast period 2013-17 at 5.75% and for perpetuity at 5.50%; above the previous 5.5% and 5.3%, but still below equity risk premiums for Krka's Hungarian peers. Our calculated WACC arrives at 11.3% for 2013-17 and 10.4% for perpetuity. Incorporating the revised estimates and changing timeframe into our model (compared to our last company update from March 2012), we arrive at a new DCF-derived 12-month target price of EUR 69.5 per share, slightly below the earlier value of EUR 73.5 per share.

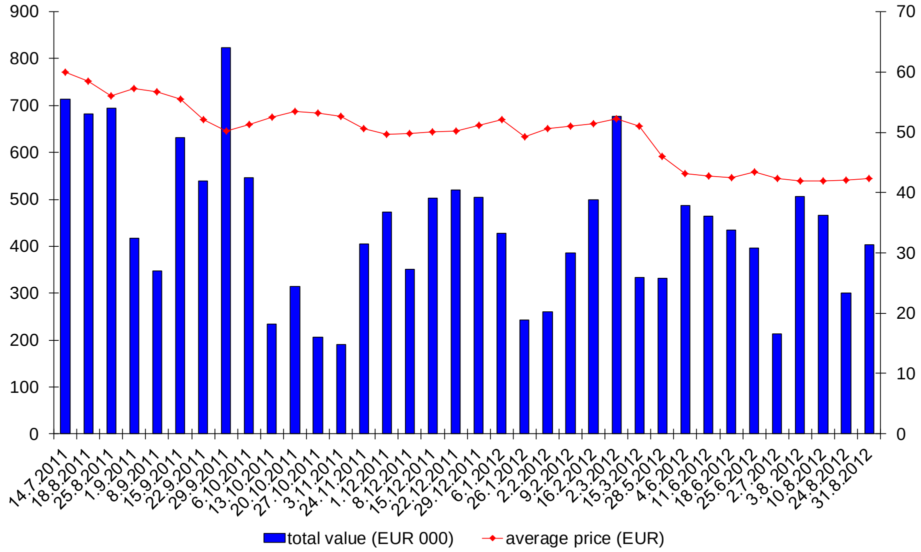
Our new target price arrives at EUR 69.5, pointing to sound upside potential for stock from its currently depressed levels. We confirm our Buy call on Krka.

We continue to believe that Krka's long-term competitive edge has yet to be reflected in its share price. Krka's fundamentals are very sound. The company boasts a well balanced sales structure, above-average profitability margins, backed by an attractive state-of-the-art generics portfolio as well as cost efficient management. Like its peers, Krka feels the recent pressure stemming from healthcare reforms in the CEE region. However, this does not pose any big threat to the company's solid growth track record. First, compared to its regional rivals, Krka has relatively high exposure to Western markets. While cost cutting is the name of the game there as well, Krka's product pipeline, full of generic bestsellers waiting for patent expirations, bodes well for the company's further sales expansion there. Secondly, Krka, as traditionally the second largest CEE-based Russia/CIS player, is well positioned to benefit from persisting Russian pharmaceutical market dynamism (with a huge drug consumption gap and solid relatively high oil price-fueled economic growth speaking in its favor going forward). All this should help it to offset the slowdown in the CEE region, which we believe is just temporary, with the CEE region's outlook promising and CEE regional pharma markets still propelled by the EU convergence story in the medium to long term. While Krka's engagement in the patent expiration-driven generics segment is inevitably accompanied by a relatively large number of pending lawsuits, it is worth mentioning that, so far, Krka has not lost a case. Although the recently turbulent forex situation in CEE has resulted in a somewhat more volatile financial result as of lately, occasionally diving into the red, being weighed down by forex losses, the medium to long-term firming trend of CEE currencies bodes well for bringing more stabilization of Krka's financial result.

Krka's home base stock exchange is in the Eurozone, with trading in the stock thus leaving no room for bad surprises on the currency side for Euro area based investors. Still, having Ljubljana as its home bourse seems to be working as a relative disadvantage compared to its Hungarian peers' Budapest home. Although being at the Ljubljana Stock Exchange's top (accounting for around half of the equity trading volume), Krka's stock's liquidity remains well below that of its Hungarian rivals (in particular that of

Richter), discouraging in part the most demanding foreign portfolio investors. The Warsaw Stock Exchange listing promised to make this problem history for Krka. Nonetheless, while Krka took this step even slightly ahead of the earlier expected schedule, the listing was done as a purely technical one, with no shares offered to investors at the time of listing in April 2012. While Krka's management remains committed to this second phase of the Warsaw listing, given the current market conditions, at the moment, there is no deadline for such a transaction. We continue to believe that the stock would benefit from such a move, as it would increase the stock's appeal, particularly for foreign portfolio investors, and would help it return to its earlier premium vs. its CEE-based sector peers (fully justified, given Krka's stable growth and above-average profitability parameters). Meanwhile, the company at least continues to gather shares on the Ljubljana Stock Exchange. However, given the persisting selling pressures from crisis-hit and cash-strapped local funds, this has lately translated into just a flat stock performance. (In 1H12, Krka repurchased 108,813 own shares, for a total value of around EUR 5.2mn, corresponding to 6.8% of the total stock turnover of Krka shares on the Ljubljana Stock Exchange.) With our DCF-based target price suggesting more than 57% upside potential, we confirm our Buy recommendation on Krka.

Krka's share gathering on the Ljubljana stock exchange continues in 2012



Source: LJSE

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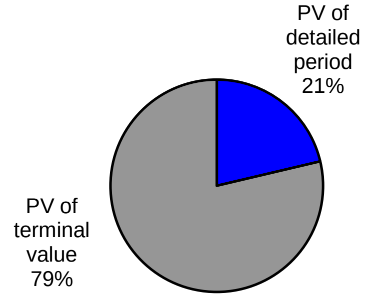
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	6.6%	6.6%	6.6%	6.6%	6.6%	5.0%
Equity risk premium	5.75%	5.75%	5.75%	5.75%	5.75%	5.5%
Beta	0.84	0.84	0.84	0.84	0.84	1.0
Cost of equity	**11.4%**	**11.4%**	**11.4%**	**11.4%**	**11.4%**	**10.5%**
Cost of debt	8.1%	8.1%	8.1%	8.1%	8.1%	6.5%
Effective tax rate	20.5%	20.0%	20.0%	20.0%	20.0%	20.0%
After-tax cost of debt	**6.4%**	**6.5%**	**6.5%**	**6.5%**	**6.5%**	**5.2%**
Equity weight	97%	97%	97%	97%	97%	99%
WACC	**11.3%**	**11.3%**	**11.3%**	**11.3%**	**11.3%**	**10.4%**

DCF valuation

(EUR mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Sales growth	*7.2%*	*7.7%*	*8.1%*	*8.5%*	*8.8%*	*7.0%*
EBIT	254.1	275.4	299.6	326.9	357.7	351.9
EBIT margin	*20.7%*	*20.8%*	*21.0%*	*21.1%*	*21.2%*	*19.5%*
Tax rate	*20.5%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Taxes on EBIT	-52.1	-55.1	-59.9	-65.4	-71.5	-70.4
NOPLAT	**202.0**	**220.3**	**239.7**	**261.5**	**286.2**	**281.5**
+ Depreciation	106.5	118.2	131.2	145.6	161.6	161.6
Capital expenditures / Depreciation	*170.6%*	*156.0%*	*143.2%*	*132.0%*	*129.8%*	*100.0%*
+/- Change in working capital	-34.4	-38.5	-43.8	-48.9	-54.5	-50.2
Chg. working capital / chg. Sales	*-41.8%*	*-41.0%*	*-40.7%*	*-40.4%*	*-40.1%*	*-42.5%*
- Capital expenditures	-181.6	-184.3	-187.8	-192.2	-209.7	-161.6
Free cash flow to the firm	**92.4**	**115.6**	**139.2**	**166.1**	**183.5**	**231.4**
Terminal value growth						*3.0%*
Terminal value						3,202.9
Discounted free cash flow - Dec 31 2012	83.1	93.3	101.0	108.2	107.5	1,820.8
Enterprise value - Dec 31 2012	**2,313.8**					
Minorities	1.5					
Non-operating assets	0.0					
Net debt	41.0					
Other adjustments	0.0					
Equity value - Dec 31 2012	**2,271.3**					
Number of shares outstanding (mn)	35.4					
Cost of equity	11.4%					
12M target price per share (EUR)	**69.5**					
Current share price (EUR)	44.2					
Up/Downside	*57.3%*					

Enterprise value breakdown



Source: Erste Group Research

Sensitivity (per share)

WACC	Terminal value EBIT margin 18.5%	19.0%	19.5%	20.0%	20.5%
9.4%	74.2	76.2	78.2	80.2	82.2
9.9%	69.8	71.7	73.6	75.4	77.3
10.4%	66.1	67.8	**69.5**	71.3	73.0
10.9%	62.8	64.4	66.0	67.7	69.3
11.4%	59.9	61.4	62.9	64.5	66.0

WACC	Terminal value growth 2.0%	2.5%	3.0%	3.5%	4.0%
9.4%	69.5	73.6	78.2	83.6	90.0
9.9%	66.0	69.5	73.6	78.2	83.6
10.4%	62.9	66.0	**69.5**	73.6	78.2
10.9%	60.2	62.9	66.0	69.5	73.6
11.4%	57.7	60.2	62.9	66.0	69.5

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Income Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS, EUR mn, 31/12)	31/12/2009	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014
Net sales	**953.04**	**1,010.02**	**1,075.63**	**1,145.97**	**1,228.20**	**1,322.24**
Cost of goods sold	-370.24	-385.41	-416.70	-443.29	-472.96	-507.47
Gross profit	**582.79**	**624.61**	**658.92**	**702.68**	**755.24**	**814.77**
SG&A	-362.31	-334.11	-356.71	-373.31	-399.21	-429.64
Other operating revenues	102.79	11.89	4.72	6.42	7.37	9.26
Other operating expenses	-88.28	-90.92	-92.93	-101.25	-109.31	-119.00
EBITDA	**311.67**	**293.19**	**301.19**	**330.44**	**360.55**	**393.55**
Depreciation/amortization	-76.68	-81.72	-87.19	-95.90	-106.45	-118.16
EBIT	**234.99**	**211.47**	**214.01**	**234.54**	**254.09**	**275.39**
Financial result	-10.67	-0.10	-14.03	-13.07	-11.00	-9.50
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**224.32**	**211.37**	**199.98**	**221.47**	**243.09**	**265.88**
Income taxes	-50.64	-40.45	-37.24	-46.51	-49.83	-53.18
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	0.08	0.11	0.07	0.07	0.08	0.09
Net result after minorities	**173.77**	**171.03**	**162.80**	**175.03**	**193.34**	**212.79**

Balance Sheet	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS, EUR mn, 31/12)						
Intangible assets	126.58	122.82	119.08	118.13	117.22	116.36
Tangible assets	649.15	686.46	703.11	766.39	843.03	927.33
Financial assets	32.30	37.23	37.27	42.87	50.37	59.18
Total fixed assets	**808.02**	**846.51**	**859.47**	**927.39**	**1,010.62**	**1,102.88**
Inventories	181.65	229.34	253.21	265.31	279.66	295.51
Receivables and other current assets	337.95	404.57	401.16	424.51	451.95	483.13
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	13.41	7.79	20.19	25.23	30.66	36.33
Total current assets	**533.01**	**641.70**	**674.56**	**715.06**	**762.27**	**814.96**
TOTAL ASSETS	**1,341.03**	**1,488.20**	**1,534.03**	**1,642.44**	**1,772.89**	**1,917.84**
Shareholders'equity	**918.69**	**1,051.75**	**1,138.24**	**1,263.68**	**1,405.65**	**1,563.53**
Minorities	**1.68**	**1.58**	**1.51**	**1.51**	**1.51**	**1.51**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
LT provisions	**107.40**	**108.89**	**104.82**	**94.34**	**84.90**	**76.41**
Interest-bearing LT debts	105.11	67.21	25.50	24.86	24.24	23.63
Other LT liabilities	25.32	26.61	24.77	19.13	14.25	13.89
Total long-term liabilities	**130.43**	**93.82**	**50.27**	**43.99**	**38.49**	**37.53**
Interest-bearing ST debts	52.78	67.72	45.40	41.35	36.97	32.28
Other ST liabilities	130.05	164.44	193.78	197.57	205.37	206.58
Total short-term liabilities	**182.83**	**232.17**	**239.18**	**238.93**	**242.33**	**238.86**
TOTAL LIAB. , EQUITY	**1,341.03**	**1,488.20**	**1,534.03**	**1,642.44**	**1,772.89**	**1,917.84**

Cash Flow Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS,EUR mn, 31/12)						
Cash flow from operating activities	165.74	181.52	247.06	246.07	256.41	262.26
Cash flow from investing activities	-91.21	-112.62	-107.44	-174.49	-181.63	-184.35
Cash flow from financing activities	-68.72	-74.52	-127.22	-66.54	-69.35	-72.24
CHANGE IN CASH , CASH EQU.	**5.81**	**-5.62**	**12.40**	**5.05**	**5.43**	**5.67**

Margins & Ratios	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Sales growth	0.3%	6.0%	6.5%	6.5%	7.2%	7.7%
EBITDA margin	32.7%	29.0%	28.0%	28.8%	29.4%	29.8%
EBIT margin	24.7%	20.9%	19.9%	20.5%	20.7%	20.8%
Net profit margin	18.2%	16.9%	15.1%	15.3%	15.7%	16.1%
ROE	20.4%	17.4%	14.9%	14.6%	14.5%	14.3%
ROCE	15.1%	13.8%	12.5%	12.9%	13.2%	13.3%
Equity ratio	68.6%	70.8%	74.3%	77.0%	79.4%	81.6%
Net debt	144.5	127.1	50.7	41.0	30.5	19.6
Working capital	350.2	409.5	435.4	476.1	519.9	576.1
Capital employed	1,197.6	1,316.0	1,320.1	1,419.6	1,536.9	1,674.9
Inventory turnover	1.9	1.9	1.7	1.7	1.7	1.8

Source: Company data, Erste Group estimates

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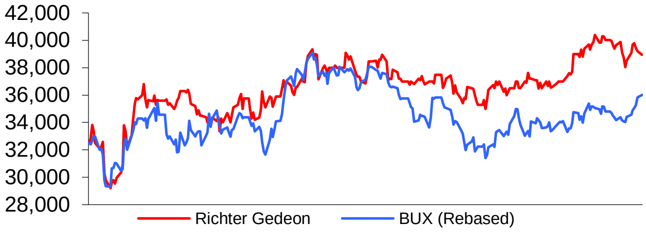
ERSTE GROUP

Richter Gedeon

Buy

HUF mn	**2011**	**2012e**	**2013e**	**2014e**
Net sales	307,868.0	325,627.8	345,720.7	375,296.9
EBITDA	85,386.0	78,917.7	80,931.8	95,298.8
EBIT	60,927.0	52,868.1	53,062.1	65,269.2
Net result after min.	49,380.0	51,333.4	52,702.0	60,799.0
EPS (HUF)	2,649.50	2,754.31	2,827.74	3,262.19
CEPS (HUF)	3,961.85	4,152.01	4,323.09	4,873.44
BVPS (HUF)	26,082.11	27,275.87	29,393.61	31,825.80
Div./share (HUF)	660.00	690.00	710.00	830.00
EV/EBITDA (x)	6.7	7.9	7.2	5.7
P/E (x)	12.9	14.1	13.8	11.9
P/CE (x)	8.6	9.4	9.0	8.0
Dividend Yield	1.9%	1.8%	1.8%	2.1%

52 weeks



Performance	**12M**	**6M**	**3M**	**1M**
in HUF	14.1%	5.3%	5.3%	-3.6%

Share price (HUF) close as of 10/09/2012	38,950
Number of shares (mn)	18.6
Market capitalization (HUF mn / EUR mn)	725,930 / 2,551
Enterprise value (HUF mn / EUR mn)	622,542 / 2,188

Reuters	GDRB.BU	Free float	74.1%
Bloomberg	RICHT HB	Shareholders	Hungarian State (25.2%)
Div. Ex-date	07/06/12		
Target price	**50,200**	Homepage:	www.richter.hu

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R&D foray set to provide more triggers for stock valuation/share price

Our revised DCF-derived 12-month target price, factoring in the somewhat reduced risk-free rate (mirroring the decreasing yields on Hungarian 10-year government bonds) and changing time frame, arrives at HUF 50,200 per share (up vs. our previous target of HUF 47,800). This suggests that, despite the solid YTD performance, the upside potential for the stock remains attractive. Consequently, we stick to our Buy recommendation on the stock.

We continue to believe that Richter's investment case remains very appealing, with benefits from its R&D foray not yet fully priced in. The company's women healthcare niche positioning, further strengthened by the Esmya launch, and traditional strong foothold in the expanding Russia/CIS market continue to represent a solid antidote to the pricing pressures at home and in some regional markets.

The most important changes to our model include the following: 1) the more sluggish than envisaged domestic sales prospects; 2) the somewhat less steep pickup in Esmya sales; 3) the less sizable OEP payments in 2012 and the coming years; 4) the positive impact of milestone income from Watson and Forest Laboratories; 5) higher sales & marketing expenses; and 6) the Esmya amortization toll on the gross margin.

In summary, we decrease our consolidated net profit target for 2012 to HUF 51,333mn, on sales of HUF 325,628mn, down 3.4% and 1.4%, respectively, compared to our previous forecasts. For 2013, we set a new net profit target of HUF 52,702mn, on sales of HUF 345,721mn.

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Changes in forecasts/outlook

Domestic market woes set to be deeper and longer lasting than originally thought.

Domestic market: Although the 1H12 domestic market performance, with sales retreating 10.8% y/y, was slightly better than we expected, the outlook is gloomier than originally thought, prompting us to take a second look at our sales projections for both 2012 and the coming years. While we still believe that (also given the already depressed 4Q11 sales level) Richter's sales drop will not hit the upper end of the traditionally cautious guidance of CEO Bogsch (envisaging Richter's domestic sales plummeting 15% to 20% y/y in 2012), we opt to lower our consolidated domestic sales target from HUF 32.1bn to HUF 31.3bn (translating into a 12% y/y drop vs. the earlier anticipated 10% y/y decline). Furthermore, with respect to the cloudy outlook, in particular the uncertainties linked to the 'blind bidding' auctions system impact, as well as some yet to be implemented (but earlier announced) savings measures in the drug subsidy budget, such as the international reference pricing system, we expect that the regulatory measures will bite more deeply than thought earlier into Richter's home top line in 2013. Although (contrary to its peers) Richter enjoys the advantage of an important part of its product portfolio (namely oral contraceptives) not being subject to tightening reimbursement rules, there is no doubt that Richter's domestic sales tempo will also be tempered going forward. For 2013, we now expect Richter's domestic sales to slip y/y, albeit relatively marginally, as the low base does not offer much room for downside. We set our new domestic sales target at HUF 29.8bn, down 5% y/y and down 8.9% compared to our previous forecast. We assume Richter's domestic sales rebounding only in 2014, returning to low single-digit growth.

Russia/CIS sales performance still seen as robust, providing backup for top line growth in coming periods.

Russia/CIS: Reflecting the relatively high comparative base (and certain pre-shipment element in 1Q), the sales rise in Russia was tempered from 16.2% y/y in 1Q12 to 6.2% y/y in 1H12 (all in ruble terms). Consequently, CEO Bogsch reiterated that he anticipates Richter's Russian sales advancing 0-5% y/y in 2012 (in ruble terms). With the extremely high sales level in 4Q11 (partly attributable to high inventory buildup at wholesalers towards the end of the year) being balanced by the subdued 3Q11 showing, we believe that the comparative base should not represent any brake on achieving the targeted 2012 sales growth tempo. Consequently, we have decided to leave our earlier forecast for Russian sales in 2012 unchanged at around EUR 338mn, corresponding to a 5% y/y rise. In addition, the company's 2Q12 performance in other CIS markets pointed to a faster than earlier envisaged revival from the somewhat lackluster 1Q12. Based on the very sound 1H12 tempo in Ukraine, Richter's sales growth is now envisaged to exceed the originally targeted 5% mark (in USD terms). Consequently, after raising our forecast for other CIS markets, we increase our target for Russia/CIS sales from EUR 476.1mn to EUR 481.8mn in 2012 (translating into a 7.1% y/y rise in EUR terms). Given the promising economic outlook (bolstered by steadily high oil prices), coupled with the relatively stable currency situation and further supported by the expansion of the local manufacturing base (doubling of the local Russian tableting capacity planned by 2014), we think that Richter's sales in the Russia/CIS region should keep their momentum in the medium term. For 2013, we slightly increase our sales target for Russia/CIS to some EUR 532.6mn (up from EUR 527.3mn), corresponding to a sales pace of around 10% y/y.

EU: While the first-time consolidation of Grünenthal's OC business in 2011 helped to propel the sales tempo in the EU region to 15.0% y/y (to EUR 389.0mn), in the absence of such a one-off boost (and Esmya proceeds kicking in rather slowly), the 2012 sales growth will undoubtedly not be as robust. In 1H12, Richter's EU sales as a total matched our forecast. At the same time, some territories even slightly surpassed our estimates (Poland by 6.1%, EU-9 by 1.3%), but others lagged slightly behind (Romania by 1.4%). Consequently, we are prompted to make adequate adjustments to our projections for 2012. While we stick to our forecast for EU-15 sales at EUR 116.0mn, we increase our sales forecasts for Poland, where, after the problematic start of the healthcare reform in January 2012, the situation is stabilizing now, with a positive impact on Richter's sales. Following EU registration in February 2012, in the course of 1H12, Esmya was launched in Germany, the UK, Hungary, Poland, the Czech Republic and Austria. The list is set to expand. Unfortunately, obtaining reimbursement status is somewhat slipping behind the original plans and, given the current healthcare cost containment measures in many countries (in particular in the CEE region), the Esmya sales pickup is envisaged to be rather slow. Consequently, we reduce our forecast here and envisage the contribution of Esmya to 2012 EU sales at just EUR 3mn (below the earlier projected EUR 15mn). As before, the positive impact from Esmya is anticipated to become more visible from 2013 onwards (and the company also hopes to obtain reimbursement status for Esmya in its home market by then), with peak sales in major EU markets to be reached some 3-4 years after market introduction, i.e. in 2015-16. All told, our new target for Richter's sales to the EU in 2012 arrives at EUR 408.5mn, corresponding to a 5.0% y/y rise. We think that (helped by the Esmya sales acceleration) our EU sales forecast for 2013 of around EUR 466.8mn is realistic.

US: Given the drying up of the revenue stream from the profit sharing arrangement with Barr Laboratories on drospirenone, Richter's US sales keep contracting as of lately. In 1H12, Richter's US sales fell 34.1% y/y (to USD 30.9mn), a slightly less steep drop than assumed by the company's full-year guidance, anticipating Richter's sales in the US decreasing around 40% y/y in USD terms in 2012. Nonetheless, as there is no significant turnaround on the horizon yet, we leave our target for Richter's US sales in 2012 broadly unchanged at USD 70.6mn. As before, for 2013, we foresee a minor increase as possible, should the cariprazine-based product hit the market before the end of the year. (If everything goes according to plan, the market launch is currently anticipated for the end of 2013/beginning of 2014.)

After factoring in all above-mentioned changes, our consolidated sales target for 2012 arrives at HUF 325.6bn.

Finally, we incorporate into our projections the new exchange rate forecast. Reflecting the firmer than earlier expected forint along with the relative strength of the US dollar, we adjust the average exchange rate from HUF 236.0/USD to HUF 230/USD for 2012, and from an average exchange rate of HUF 295.0/EUR to HUF 290/EUR for 2012. For 2013, we revise our forecast from the average exchange rate of HUF 224/USD to HUF 229.5/USD and from the average exchange rate of HUF 279.0/EUR to HUF 278.0/EUR. After factoring in all of the above-mentioned changes, our consolidated sales target for 2012 arrives at HUF 325.6bn, slightly down from the previous forecast of HUF 330.3bn, with some HUF 38.4bn to be delivered by wholesale and retail operations and HUF 287.2bn to be contributed by the pharmaceutical business segment. For 2013, our new consolidated sales target is at HUF 345.7bn (below the earlier HUF 357.4bn), out of which HUF 305.8bn is expected to come from the pharmaceutical segment and HUF 40.0bn from the wholesale and retail arm.

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Changes to 2012 and 2013 consolidated forecasts

Consolidated, IFRS (HUF, mn)	2012e Now	Before	Change	2013e Now	Before	Change
Sales	**325,628**	**330,276**	***-1.4%***	**345,721**	**357,408**	***-3.3%***
Cost of sales	123,256	124,454	*-1.0%*	130,174	134,274	*-3.1%*
Gross profit	**202,372**	**205,822**	***-1.7%***	**215,547**	**223,134**	***-3.4%***
Sales & marketing costs	90,850	85,428	*6.3%*	95,193	90,682	*5.0%*
Admin. & general costs	21,817	22,376	*-2.5%*	22,990	23,946	*-4.0%*
R&D costs	38,815	39,303	*-1.2%*	40,968	42,532	*-3.7%*
Other income / expense	1,978	-2,656	*n.m.*	-3,333	-4,826	*-30.9%*
Operating profit	**52,868**	**56,059**	***-5.7%***	**53,062**	**61,149**	***-13.2%***
Net financial income	801	1,170	*-31.5%*	2,633	2,601	*1.2%*
Taxation	2,147	4,006	*-46.4%*	2,785	4,781	*-41.8%*
Minorities	-189	-75	*152.9%*	-208	-82	*152.9%*
Net profit	**51,333**	**53,148**	***-3.4%***	**52,702**	**58,886**	***-10.5%***
Gross margin	62.1%	62.3%		62.3%	62.4%	
EBIT margin	16.2%	17.0%		15.3%	17.1%	
Net margin	15.8%	16.1%		15.2%	16.5%	

Source: Erste Group Research

Gross margin set to benefit from weak forint, improving sales mix in 2012.

In 1H12, bolstered by the improving sales mix (higher than envisaged Russia/CIS sales) complementing the benefits from the weak forint, Richter's gross margin (at 62.2%) ended slightly above our estimate of 61.7%. Nonetheless, going forward, we assume that the positive effects of the currency situation will drop off, while the pricing pressures both at home and in CEE markets will persist. In addition, since 2Q12, following the Esmya product launch, Richter started to account for Esmya related amortization in its cost of goods sold (HUF 616mn per quarter). Hence, we do not see room for an upward revision of our forecast - rather the opposite. Consequently, we opt to adjust our target for the 2012 consolidated gross margin slightly downwards, from 62.3% to 62.1%. As the pricing pressures associated with healthcare reform in CEE markets, along with the appreciation of the Hungarian currency, will largely erase the benefits of the improving sales mix, we continue to anticipate an only minor improvement in the gross profitability margin in the coming years as possible. For 2013, we fine-tune our forecast for the gross margin to 62.3%.

Sales and marketing costs set to outpace top line tempo for time being, driven by Western European sales network expansion, Esmya market introduction.

Following an acceleration in 2Q, sales and marketing expenditures surged 19.8% y/y in 1H12 to account for 28.0% of total sales in the period, ending 5.7% ahead of our expectations. Although the high level of sales & marketing spending in 2Q was partly attributable to the Esmya market launch related activities in the period, referring to the ongoing buildup of sales and marketing infrastructure in Western European markets, amortization of marketing and patent rights acquired from Grünenthal, as well as strong activities in Russia/CIS, the company lifted its guidance for sales & marketing expenses from 26.5-27% to 28-29% of consolidated sales in 2012. Furthermore, according to CEO Bogsch, sales and marketing expenses should stay around the same level, i.e. 28% of consolidated sales, in 2013. Consequently, we are forced to make adequate adjustments to our forecasts. For 2012, we now envisage sales and marketing costs at 27.9% (vs. the earlier projected 25.9%) of consolidated sales. For 2013, we assume another increase, albeit somewhat less steep than the company's current guidance, but still translating into a substantial hike in relative terms compared to our previous forecast (from 25.4% to 27.5% of total sales).

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Reflecting advanced stages of R&D projects in cooperation with Forest Laboratories, R&D costs estimated to expand to around 12% of sales in 2012.

The research and development cost development on a quarterly basis tends to be uneven, with dynamism dictated to a large extent by the progress in R&D cooperation projects with Forest Laboratories. In 1H12, R&D spending was up a robust 21.8% y/y to HUF 20,024mn, corresponding to 12.1% of sales, only slightly above our projections. Reflecting in part the start of the phase III clinical trials of Esmya in a new indication, the company's CEO recently reiterated the guidance envisaging R&D costs accounting for around 12% in 2012. Consequently, we continue to project R&D expenses for 2012 at 11.9% of sales (or around HUF 39bn). For 2013, we anticipate R&D spending remaining at the same level in relative terms as in our previous forecast, i.e. 11.9% of sales.

Home market regulatory toll significantly less substantial than thought earlier. Potential milestone payments to give lift to the other income/expense balance.

As per the amendment to the healthcare law, Richter is entitled to reclaim part of its 2011 OEP payments in 2012. While in February 2012, the company informed that, in 2012, reflecting the R&D-based relief, its regulatory toll will decrease by some HUF 2bn compared to the original expectations, the final bill seems now to be significantly lower. In 1H12, Richter booked medical rep fees of just HUF 431mn (under sales and marketing costs) and the 20% tax obligation payable in respect of turnover related to reimbursed sales in Hungary amounted to HUF 471mn at the same time. As we were informed by the company, in the best case scenario the available relief will be sufficient to eliminate the impact of OEP payments on its P&L account for the rest of the year, an outcome far better than we estimated earlier (a burden of HUF 2bn in 2012).

Furthermore, the 1Q12 performance was already marked by two major one-offs – a milestone payment from Watson related to commencement of phase III clinical trials for Esmya in the US and a milestone from Forest Laboratories connected to a small CNS R&D project (the name of the product candidate was not disclosed and the company pointed out that it is in a relatively early stage), totaling some HUF 3bn. According to CEO Bogsch, while no further milestone is envisaged from Watson in the near future (2012 and 2013), the next milestone from Forest Laboratories is expected to be received already in 4Q12, based on the anticipated cariprazine product filing with the US FDA. Unfortunately, as before, Bogsch remained tightlipped about the estimated size of the related milestone payment to be paid to Richter by its partner. Given the still uncertain timing and size of payment, we opt to leave the potential upcoming milestone proceeds from Forest Laboratories as an interesting upside.

In summary, our other income/expense balance target arrives at a positive HUF 2.0bn (vs. the earlier projected loss of HUF 2.7bn) in 2012. While Hungarian pharma industry manufacturers have not halted their lobbying activities, and they may succeed in receiving at least some partial relief at the end of the year (as was the case last year), based on the current regulation, in the coming years, R&D-based relief for the OEP payments is still impossible. Although the picture might become rosier (should the possible future milestone payment from Forest Laboratories, linked to the cariprazine product approval, be obtained already in 2013 and/or R&D-based relief to the OEP payments become available once again), we project that, dragged down by the OEP payments, the other income/expense balance will dip into red territory in 2013. Nevertheless, with respect to the somewhat lower OEP payments (mirroring the decreasing domestic sales, along with lower reimbursement levels) in 2013, we envisage the other income/expense balance at a loss of HUF 3.3bn (less sizable than the earlier projected loss of HUF 4.8bn).

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Reflecting more sizable sales & marketing spending, we reduce our operating profit forecast for 2012 to HUF 52.9bn. For 2013, we set new EBIT target at HUF 53.1bn.

Incorporating in particular the lower OEP payment related regulatory burden along with positive one-off effects from milestones received in 1Q on one side, but mounting sales & marketing expenses on the other side, our new operating profit target arrives at HUF 52,868mn for 2012 (compared to the earlier estimate of HUF 56,059mn), corresponding to a consolidated operating profit margin of 16.2%. For 2013, with the less sizable hike in the home market regulatory toll more than offset by the significantly higher than earlier projected sales & marketing costs, we expect the EBIT margin to deteriorate in a y/y comparison. We set the EBIT margin target at 15.3%, somewhat below our previous forecast of 17.1%.

Financial result volatile, mirroring forint fortunes.

The Hungarian forint has been one of the most volatile regional currencies thus far this year, with its movements reflecting the changing market perceptions of the country's macroeconomic outlook and likelihood of clinching a deal with the IMF/EU. In addition, the currencies of Richter's crucial regional export markets, such as the Polish zloty, Romanian leu and Russian ruble, witnessed sizable quarterly swings in 2012, with the reassessment of currency related trade receivables and payables resulting in ups and downs for Richter's financial result this year. On top of that, since 2011, Richter's financial result has been affected by the regular reassessments related to the deferred purchase price of PregLem (stated in Swiss francs) along with the reassessment of credit (in EUR). In 1H12, the unrealized financial gain amounted to HUF 2,057mn (as the 2Q12 loss erased HUF 3,132mn out of the 1Q12 gain of HUF 5,189mn). The realized financial result stood at a negative HUF 1,314mn after the first six months, as the 2Q12 gain of HUF 1,719mn partly compensated for the 1Q12 loss of HUF 3,033mn. Going forward, we anticipate that Richter's financial result will be volatile, with (in particular) the end of the quarter (the decisive date for periodic reassessment) exchange rates still difficult to predict, but nonetheless crucial for the final outcome. At the moment, we do not anticipate any need to account for impairment losses (as was the case in 2011). Thus, at least the share of associates seems to be ending in positive territory in 2012 and hence better than we originally envisaged. While the recent forint firming prompts us to take a more cautious stance, the adjustment to our original forecast for net financial income for 2012 is not dramatic - from HUF 1.18bn to HUF 0.8bn. For 2013, we opt to leave our financial result forecast broadly unchanged at around HUF 2.6bn.

We expect that, bolstered by low effective tax rate, 2012 net profit will rise 4% y/y.

Until 2011 (inclusive), Richter enjoyed a 100% tax holiday in Hungary. With the majority of taxable income derived from the company's home operations, the resulting effective tax rate on the group level was very low. Nonetheless, although the tax holiday came to an end, allowances related to investments (in particularly, related to the Debrecen biotech plant construction) are still available, and the effective tax rate of just 6.5% in 1H12 even stood below our original forecast. Consequently, reflecting the latest company guidance, we assume that the effective tax rate will be around 4.0% in 2012, rising to 5.0% in 2013 and 12% in 2014/15. In summary, our new consolidated net profit target arrives at HUF 51,333mn for 2012, corresponding to an 4.0% y/y increase (this compares to our previous forecast of HUF 53,148mn net profit and an 8.0% y/y rise). For 2013, we forecast Richter's consolidated net profit at HUF 52,702mn (up 2.7% y/y, but down 10.5% compared to our previous estimate).

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2Q12 results review

Richter announced its 2Q12 results on August 2, 2012. Reflecting the y/y more favorable forex fortunes, as well as the low comparative base, Richter's 2Q12 bottom line surged 33.7% y/y. While it lagged slightly behind the market consensus, it surpassed our somewhat less bullish forecast.

2Q12 results review

Consolidated sales review	2Q2012	2Q2011	y/y	1H2012	1H2011	y/y
Hungary (HUF mn)	8,338	9,693	*-14.0%*	17,114	19,192	*-10.8%*
USA (EUR mn)	15.8	21.5	*-26.5%*	23.8	33.3	*-28.5%*
EU (EUR mn)	98.2	93.4	*5.1%*	201.7	189.8	*6.3%*
Russia, CIS (EUR mn)	127.0	113.7	*11.7%*	248.3	216.7	*14.6%*
Other (EUR mn)	16.1	17.0	*-5.3%*	30.6	31.1	*-1.6%*
Total export (EUR mn)	257.1	245.6	*4.7%*	504.4	470.9	*7.1%*
IFRS consolidated	**2Q2012**	**2Q2011**	***y/y***	**1H2012**	**1H2011**	***y/y***
Total sales (HUF mn)	84,012	75,068	*11.9%*	166,018	145,907	*13.8%*
Operating profit (HUF mn)	13,130	13,162	*-0.2%*	28,485	23,390	*21.8%*
Net income (HUF mn)	11,367	8,500	*33.7%*	28,119	19,675	*42.9%*
Operating margin	*15.6%*	*17.5%*		*17.2%*	*16.0%*	
Net margin	*13.5%*	*11.3%*		*16.9%*	*13.5%*	

Source: Richter Gedeon

Domestic sales: Reflecting the mounting pricing pressures, Richter's domestic sales performance in 2Q12 was rather weak, with sales contracting 14% y/y to HUF 8,338mn. With respect to the previous period's sluggish showing, this translated into a 10.8% y/y decrease in Richter's domestic sales in 1H12.

Exports: The export picture was more optimistic, as the drop in US sales as well as subdued sales in some CEE markets (like Romania) were compensated for by an excellent CIS performance, complemented by a women's healthcare niche portfolio-fueled rise y/y in the EU-15 and EU-9. In 2Q12, Richter's exports advanced 4.7% y/y to EUR 257.1mn. The y/y diminishing drospirenone related revenue stream dragged down sales in the US (sales down 26.5% y/y to EUR 15.8mn). On the other hand, although the previous quarter's stockpiling tempered the rise in Russia, driven by a strong pickup in other CIS markets, sales growth in Russia/CIS was at an excellent 11.7% y/y in 2Q12, lifting total **Russia/CIS** sales to EUR 248.3mn (up 14.6% y/y) in 1H12. As the negative impact from unfavorable market conditions on the Romanian market and price erosion in both CEE and Western Europe was to a large extent offset by the expanding sales of Richter's gynecological portfolio, further augmented by the initial effect from the Esmya market launch, the company's 2Q12 sales in the **EU** went up 5.1% y/y to EUR 98.2mn. After launches in Germany and the UK in March 2012, Esmya was introduced in the course of 2Q12 in Hungary, Poland, the Czech Republic and Austria.

Profitability: As the negative impact from the y/y slump in US sales revenues (including profit sharing) and somewhat higher y/y share of the low-margin wholesale and retail segment, along with amortization charges related to the Esmya launch, were not completely offset by the benefits stemming from the y/y weakening of the Hungarian forint vs. the USD/EUR, along with the expanding share of high-margin Russia/CIS sales and the Gruenenthal OC portfolio contribution, Richter's consolidated gross margin slightly deteriorated y/y, from 63.1% in 2Q11 to 62.9% in 2Q12. Weighed down by increasing sales and marketing as well as R&D expenses, the operating profit margin sunk to 15.6% in 2Q12 (down from the year-earlier 17.5%). The most decisive factor for the bottom line performance was again the financial result. Hampered by the revaluation losses linked to the end of the quarter changing forex situation (namely, the reassessment of currency related trade receivables and payables and of other currency related items, as well as the unwinding of discounted value related to liability with respect to PregLem), the financial result remained in negative territory. However, the financial loss of HUF 1.4bn was significantly less sizable y/y (the year-earlier loss amounted to HUF 3.4bn). On top of that, the share of associates contributed positively to the net financial balance this time.

Valuation / Recommendation

Our 12-month target price arrives at HUF 50,200 per share; despite solid YTD performance, upside potential has yet to evaporate.

We have reviewed the parameters of our DCF model. In line with our previous sector report from March 2012, we use the methodology for setting equity risk premiums based on S&P long-term currency ratings. With no changes in Richter's home country rating, we stick to the equity risk premium of 7.15% for the explicit forecast period of 2013-17 and 6.65% for perpetuity. Furthermore, although the current situation is still a bit shaky, yields on Hungarian 10-year government bonds have declined considerably since the high reached at the time of publication of our last report. Moreover, in the medium to long run, Hungarian government bond yields are envisaged to drop further. Hence, we decrease our risk-free rate assumption from 8.6% to 7.5% for the detailed forecast period of 2013-17. Consequently, our WACC is at 13.0% for 2013-17 and 11.2% for perpetuity. All told, reflecting the revised projections as well as changing timeframe, our DCF-derived 12-month target price arrives at HUF 50,200 per share, vs. our earlier target of HUF 47,800 per share.

The solid YTD performance (with Richter's share price up 13.9% and outperforming the BUX rising by 4.5% at the same time) provided more evidence that, in the still relatively turbulent Hungarian equity market context, Richter represents one of the most preferred investment opportunities. Thanks to its high export profile, with still dynamic Russia/CIS as its traditional stronghold, Richter was able to mitigate the negative impact of the austerity measures of the Hungarian government (hurting the Hungarian pharmaceutical market) on its business performance. With the majority of its costs in forints and high share of exports (89.7% of total sales in 1H12), Richter is one of the beneficiaries of the weak forint, lifting the export figure in HUF terms and boding well for achieving solid profitability margins. Although the forint is anticipated to appreciate in the coming periods, removing the cushion for Richter's profitability parameters, with the stabilizing situation, the risks attached to an investment in Hungarian stocks should decrease as well (sending yields on government bonds down). Consequently, on the valuation side, this factor should to a large extent compensate for less favorable currency effects, leaving our DCF-derived target price largely intact.

Richter's investment story is like no other in the currently investable CEE pharma universe. Namely, Richter remains the only CEE generics player with an ever-increasing chance to bring (in cooperation with its US partner Forest Laboratories) an original drug to the market. Importantly, the related news flow is set to intensify in the coming period. In February 2012, the positive preliminary data from cariprazine phase III clinical trials in patients with acute mania associated with bipolar I disorder were soon followed by the more critically watched top line data from phase III clinical studies on cariprazine for schizophrenia. Recently, CEO Bogsch confirmed that the

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Cariprazine product filing is anticipated to take place in 4Q12.

cariprazine product filing with the US FDA by Forest Laboratories is still anticipated to take place in 4Q12. After we lifted the likelihood of success of the project to 75% in February this year, the cariprazine contribution to our target price arrives at HUF 4,585 per share. As the product moves on its path to the market, we plan to fine-tune our assumptions here, including lifting probabilities. In any case, the bias for Richter's valuation is still on the upside. Furthermore, Richter's future product pipeline contains more possible catalysts; apart from cariprazine being tested in other adjunct indications (major depression), the company still owes investors its final word on the cariprazine EU market entry strategy - talks with possible partners are underway and more should hopefully be known later this year.

Esmya potential might be significantly higher than currently assumed.

In addition, the Esmya potential might be significantly higher than currently assumed, should the phase III clinical trials (initiated by Richter this year), aimed at expanding the indication for Esmya to a long-term myoma treatment, be successfully concluded. According to the company's estimates, adding the new indication may result in doubling peak sales for Esmya (from the currently envisaged EUR 100-150mn to EUR 200-300mn). For comparison, in our model, we currently calculate with Esmya peak sales of EUR 220mn (to be reached in 2018) and see Esmya as contributing HUF 1,550 per share to our target price.

Last but not least, the company is making steady progress regarding its presence in the biosimilars field. Similarly to other market participants, we lack visibility about the program and its benefits (and hence do not incorporate them into our valuation), and we acknowledge that they might also be rather distant from the current perspective. We nonetheless deem them interesting to watch and adding attractiveness to Richter's investment case in the medium to long term.

With its R&D foray set to yield tangible results soon, Richter's investment story should lure more investors. We stick to our Buy call.

In summary, we continue to think that Richter has all pre-requisites to defend its position as a long-term safe bet in the turbulent Hungarian equity market, with the R&D news pipeline providing interesting triggers in the foreseeable future. With the share price offering 28.9% upside potential to our revised target price of HUF 50,200 per share, we stick to our Buy call on the stock.

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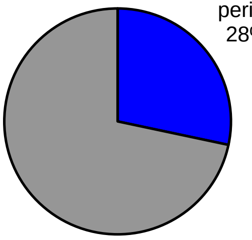
WACC calculation

	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Risk free rate	7.5%	7.5%	7.5%	7.5%	7.5%	5.0%
Equity risk premium	7.15%	7.15%	7.15%	7.15%	7.15%	6.65%
Beta	0.84	0.84	0.84	0.84	0.84	1.0
Cost of equity	**13.5%**	**13.5%**	**13.5%**	**13.5%**	**13.5%**	**11.7%**
Cost of debt	8.0%	8.0%	8.0%	8.0%	8.0%	5.5%
Effective tax rate	5.0%	12.0%	12.0%	14.0%	14.0%	19.0%
After-tax cost of debt	**7.6%**	**7.0%**	**7.0%**	**6.9%**	**6.9%**	**4.5%**
Equity weight	92%	92%	92%	92%	92%	94%
WACC	**13.0%**	**13.0%**	**13.0%**	**13.0%**	**13.0%**	**11.2%**

DCF valuation

(HUF mn)	2013e	2014e	2015e	2016e	2017e	2018e (TV)
Sales growth	*6.2%*	*8.6%*	*10.2%*	*10.2%*	*10.3%*	*8.0%*
EBIT	53,062.1	65,269.2	76,419.6	87,386.8	99,026.3	105,883.7
EBIT margin	*15.3%*	*17.4%*	*18.5%*	*19.2%*	*19.7%*	*19.5%*
Tax rate	*5.0%*	*14.0%*	*14.0%*	*14.0%*	*14.0%*	*19.0%*
Taxes on EBIT	-2,653.1	-9,137.7	-10,698.7	-12,234.1	-13,863.7	-20,117.9
NOPLAT	**50,409.0**	**56,131.5**	**65,720.8**	**75,152.6**	**85,162.6**	**85,765.8**
+ Depreciation	27,869.6	30,029.6	32,089.6	34,449.6	36,909.6	36,909.6
Capital expenditures / Depreciation	*107.4%*	*106.9%*	*105.3%*	*104.3%*	*102.3%*	*100.0%*
+/- Change in working capital	-978.8	-1,506.6	-2,429.8	-3,503.6	-5,182.2	-4,625.5
Chg. working capital / chg. Sales	*-4.9%*	*-5.1%*	*-6.4%*	*-8.3%*	*-11.0%*	*-11.5%*
- Capital expenditures	-29,942.6	-32,089.2	-33,774.4	-35,935.5	-37,752.2	-36,909.6
Free cash flow to the firm	**47,357.2**	**52,565.3**	**61,606.2**	**70,163.1**	**79,137.8**	**81,140.3**
Terminal value growth						*3.0%*
Terminal value						1,016,075.2
Discounted free cash flow - Dec 31 2012	41,897.3	41,159.7	42,694.3	43,040.4	42,970.9	535,646.8
Enterprise value - Dec 31 2012	**747,409.3**					
Minorities	3,920.9					
Non-operating assets	0.0					
Net debt	-107,309.1					
Other adjustments	0.0					
Equity value - Dec 31 2012	**850,797.5**					
Number of shares outstanding (mn)	18.6					
Cost of equity	13.5%					
12M target price per share (HUF)	50,200					
Current share price (HUF)	38,950					
Up/Downside	*28.9%*					

Enterprise value breakdown



Source: Erste Group Research

Sensitivity (per share)

WACC	Terminal value EBIT margin 18.5%	19.0%	19.5%	20.0%	20.5%
10.2%	52,624	53,599	54,574	55,549	56,524
10.7%	50,421	51,333	52,245	53,158	54,070
11.2%	48,487	49,343	**50,200**	51,056	51,913
11.7%	46,774	47,581	48,389	49,196	50,004
12.2%	45,247	46,010	46,774	47,538	48,301

WACC	Terminal value growth 2.0%	2.5%	3.0%	3.5%	4.0%
10.2%	50,200	52,245	54,574	57,249	60,354
10.7%	48,389	50,200	52,245	54,574	57,249
11.2%	46,774	48,389	**50,200**	52,245	54,574
11.7%	45,325	46,774	48,389	50,200	52,245
12.2%	44,018	45,325	46,774	48,389	50,200

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Income Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS, HUF mn, 31/12)	31/12/2009	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014
Net sales	**267,344.00**	**275,312.00**	**307,868.00**	**325,627.76**	**345,720.73**	**375,296.86**
Cost of goods sold	-116,443.00	-107,137.00	-114,529.00	-123,255.63	-130,174.14	-140,462.57
Gross profit	**150,901.00**	**168,175.00**	**193,339.00**	**202,372.13**	**215,546.59**	**234,834.29**
SG&A	-70,983.00	-81,434.00	-103,527.00	-112,667.20	-118,183.61	-123,489.13
Other operating revenues	0.00	0.00	0.00	0.00	0.00	0.00
Other operating expenses	-27,449.00	-24,088.00	-28,885.00	-36,836.83	-44,300.84	-46,075.97
EBITDA	**72,184.00**	**83,788.00**	**85,386.00**	**78,917.72**	**80,931.77**	**95,298.82**
Depreciation/amortization	-19,715.00	-21,135.00	-24,459.00	-26,049.62	-27,869.62	-30,029.62
EBIT	**52,469.00**	**62,653.00**	**60,927.00**	**52,868.10**	**53,062.15**	**65,269.20**
Financial result	4,431.00	5,123.00	-11,256.00	801.30	2,632.71	4,080.78
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**56,900.00**	**67,776.00**	**49,671.00**	**53,669.40**	**55,694.86**	**69,349.98**
Income taxes	-5,947.00	-3,136.00	-119.00	-2,146.78	-2,784.74	-8,322.00
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	33.00	-161.00	-172.00	-189.20	-208.12	-228.93
Net result after minorities	**50,986.00**	**64,479.00**	**49,380.00**	**51,333.42**	**52,701.99**	**60,799.05**

Balance Sheet	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS, HUF mn, 31/12)						
Intangible assets	14,558.00	185,116.00	198,806.00	195,990.76	197,421.14	194,591.52
Tangible assets	142,363.00	144,674.00	155,630.00	155,931.00	160,631.00	170,431.00
Financial assets	18,247.00	29,694.00	25,148.00	25,776.70	26,421.12	27,081.65
Total fixed assets	**175,168.00**	**359,484.00**	**379,584.00**	**377,698.46**	**384,473.26**	**392,104.17**
Inventories	51,459.00	51,657.00	63,437.00	64,244.85	65,310.21	67,352.57
Receivables and other current assets	88,333.00	96,251.00	114,861.00	117,284.14	119,607.54	122,688.59
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	115,010.00	95,885.00	130,403.00	172,335.90	208,967.67	247,616.03
Total current assets	**254,802.00**	**243,793.00**	**308,701.00**	**353,864.89**	**393,885.42**	**437,657.19**
TOTAL ASSETS	**429,970.00**	**603,277.00**	**688,285.00**	**731,563.35**	**778,358.67**	**829,761.36**
Shareholders'equity	**376,142.00**	**438,984.00**	**486,105.00**	**508,353.56**	**547,822.94**	**593,152.87**
Minorities	**2,613.00**	**3,131.00**	**3,863.00**	**3,920.95**	**3,979.76**	**4,039.46**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
LT provisions	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Interest-bearing LT debts	702.00	41,694.00	62,226.00	64,780.80	63,585.60	58,816.68
Other LT liabilities	818.00	57,410.00	30,065.00	24,052.00	23,811.48	23,573.37
Total long-term liabilities	**1,520.00**	**99,104.00**	**92,291.00**	**88,832.80**	**87,397.08**	**82,390.05**
Interest-bearing ST debts	5,387.00	21.00	164.00	246.00	369.00	553.50
Other ST liabilities	44,308.00	62,037.00	105,862.00	130,210.04	138,789.90	149,625.49
Total short-term liabilities	**49,695.00**	**62,058.00**	**106,026.00**	**130,456.04**	**139,158.90**	**150,178.99**
TOTAL LIAB. , EQUITY	**429,970.00**	**603,277.00**	**688,285.00**	**731,563.35**	**778,358.67**	**829,761.36**

Cash Flow Statement	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
(IAS,HUF mn, 31/12)						
Cash flow from operating activities	73,135.00	74,674.00	77,469.00	77,191.69	80,879.23	90,791.06
Cash flow from investing activities	-25,941.00	-116,372.00	-39,462.00	-25,035.72	-29,942.64	-32,089.17
Cash flow from financing activities	-10,232.00	21,604.00	-5,251.00	-10,223.07	-14,304.82	-20,053.53
CHANGE IN CASH , CASH EQU.	**35,838.00**	**-17,694.00**	**43,051.00**	**41,932.90**	**36,631.77**	**38,648.36**

Margins & Ratios	**2009**	**2010**	**2011**	**2012e**	**2013e**	**2014e**
Sales growth	13.0%	3.0%	11.8%	5.8%	6.2%	8.6%
EBITDA margin	27.0%	30.4%	27.7%	24.2%	23.4%	25.4%
EBIT margin	19.6%	22.8%	19.8%	16.2%	15.3%	17.4%
Net profit margin	19.1%	23.5%	16.1%	15.8%	15.3%	16.3%
ROE	14.3%	15.8%	10.7%	10.3%	10.0%	10.7%
ROCE	17.5%	17.0%	10.6%	11.1%	12.0%	13.6%
Equity ratio	88.1%	73.3%	71.2%	70.0%	70.9%	72.0%
Net debt	-108,921.0	-54,170.0	-68,013.0	-107,309.1	-145,013.1	-188,245.9
Working capital	205,107.0	181,735.0	202,675.0	223,408.8	254,726.5	287,478.2
Capital employed	270,652.0	445,355.0	452,020.0	429,017.4	430,601.1	432,519.8
Inventory turnover	2.2	2.1	2.0	1.9	2.0	2.1

Source: Company data, Erste Group estimates

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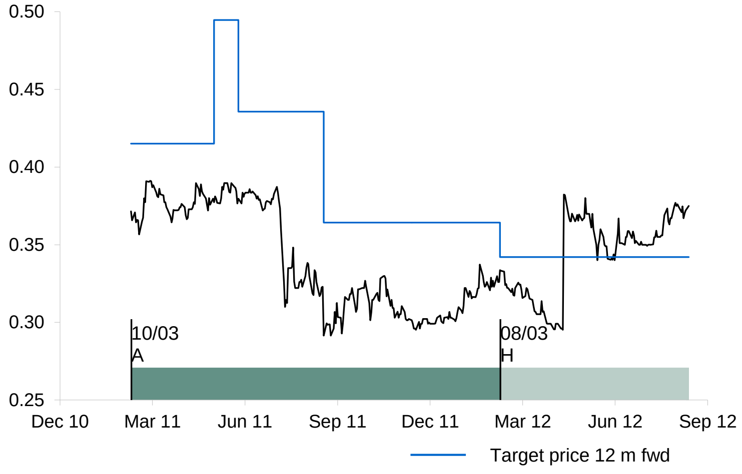
Antibiotice



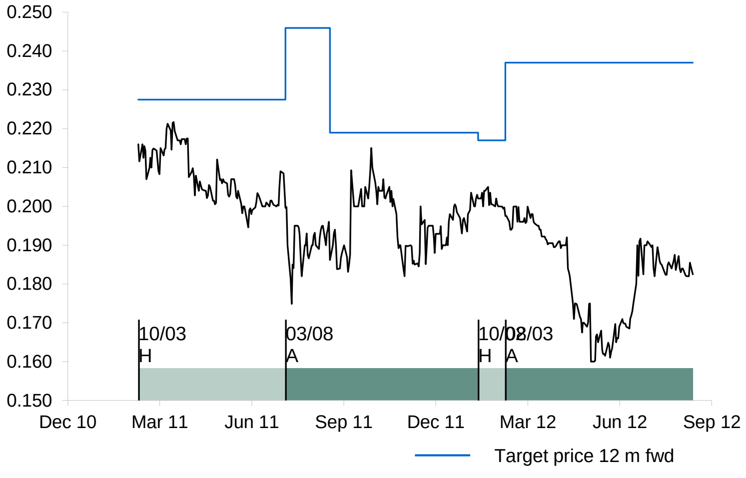
Rating history

Date	Rating	Price	Target Price
08. Mar 12	Hold	0.33	0.34
02. Feb 11	Accumulate	0.36	0.42
21. Jun 10	Hold	0.36	0.38
06. Nov 09	Reduce	0.38	0.38

Company description

Antibiotice Iasi is Romania' largest anti infective drugs producer and the only producer of injectable cephalosporin, the company ranking 10th on the Romanian pharmaceutical market with a 2.7% market share. The company is strategic for the Romanian healthcare system and sells almost 40% of output towards hospitals. Antibiotice is also world's second largest producer of active substance Nystatin, owing a market share of 25%. The product portfolio weights towards Rx drugs which accounted for some 80% of sales over the last three years.

Biofarm



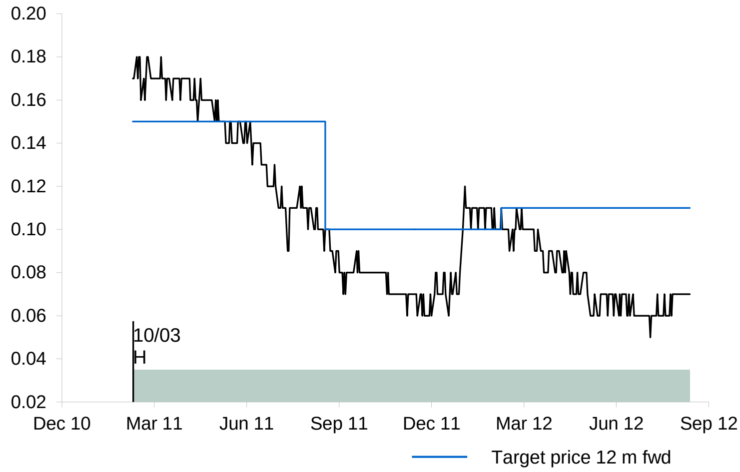
Rating history

Date	Rating	Price	Target Price
08. Mar 12	Accumulate	0.20	0.24
10. Feb 12	Hold	0.20	0.22
03. Aug 11	Accumulate	0.20	0.25
02. Feb 11	Hold	0.22	0.23
28. Jun 10	Accumulate	0.17	0.23
06. Nov 09	Hold	0.20	0.21

Company description

Biofarm was set up in 1924, being one of the oldest and important Romanian drug producers. Company's drug portfolio consists mostly of OTC drugs and nutritive supplements, which account for more than 80% of sales. With few traditional brands and affordable prices, Biofarm managed to consolidate its position on few market niches such as digestive disorders treatment, cold/flu treatment and liver protection.

Bioton



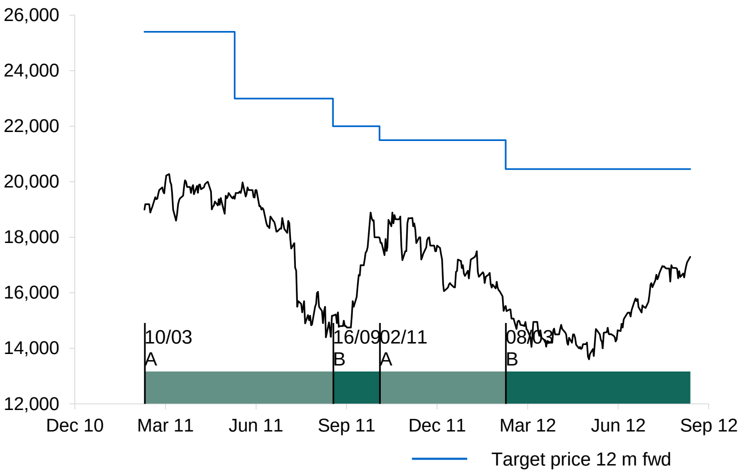
Rating history

Date	Rating	Price	Target Price
29. Jul 09	Hold	0.30	0.31
29. Jan 09	Reduce	0.20	0.19
16. Jan 09	Under review	0.23	
14. Jan 08	Hold	0.94	1.03
15. Jun 07	Accumulate	1.96	2.25

Company description

Bioton entered the Polish stock market in March 2005. While the company was originally engaged in antibiotics manufacturing, thanks to its investment in up-to-date human insulin technology, insulin became the driver of its current success. Bioton is the only company in the CEE region manufacturing modern human insulin, and, given the still unsaturated insulin market in the region (especially in Russia) and the company's distinctive price competitiveness as well as expanding cooperation network, Bioton's long-term prospects are promising. Its expansion targets include China, India and other Asian markets.

Egis



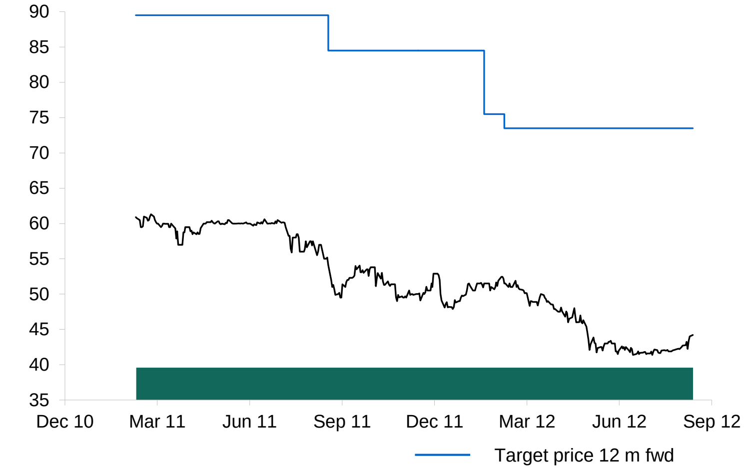
Rating history

Date	Rating	Price	Target Price
08. Mar 12	Buy	15525.00	20455.00
02. Nov 11	Accumulate	17985.00	21500.00
16. Sep 11	Buy	15180.00	22000.00
29. Jul 09	Accumulate	17800.00	21785.00
27. Feb 08	Buy	18850.00	24400.00
24. Oct 06	Accumulate	26570.00	31120.00
26. May 06	Buy	28820.00	35600.00
17. Aug 05	Accumulate	17995.00	20400.00
20. May 05	Buy	16950.00	20450.00
18. Aug 03	Accumulate	7600.00	11250.00

Company description

Egis, the fifth-largest player in the Hungarian pharmaceutical market by sales, already has a strategic partner – in contrast to rival Richter. France's Servier bought 50.9% of Egis in December 1995. Despite this, Egis remains the focus of international investors, who appreciate the company's steadily expanding exports. Egis' cooperation with Servier accounted for 22% of Hungarian company's consolidated sales in 2010/11, and consisted of sales of drugs licensed by Servier to Egis in the Hungarian and CEE markets, bulk supplies from Egis to Servier, and sales of Egis products in France.

Krka



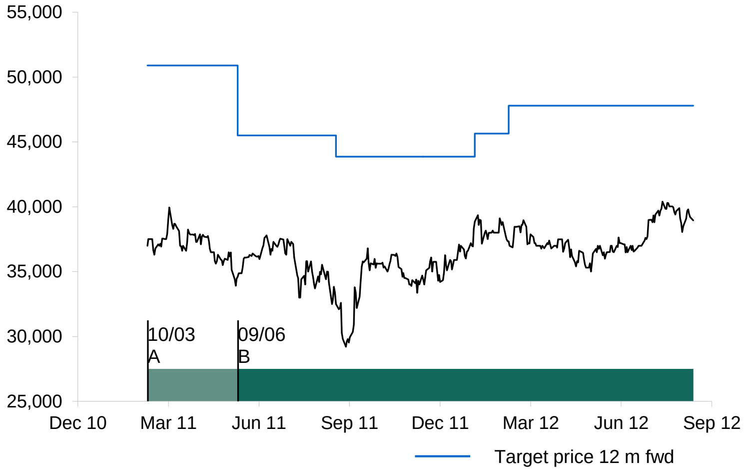
Rating history

Date	Rating	Price	Target Price
30. Nov 07	Buy	113.58	139.50
02. Apr 07	Accumulate	83.05	96.00

Company description

Krka remains one of the best long-term investment opportunities for foreign and domestic institutional investors on the Ljubljana Stock Exchange (LJSE). With trading volume of EUR 173.1mn in 2011, Krka ranked as the most liquid Slovenian stock on the LJSE. Traditionally viewed as a Russian player (closely following Richter, in absolute terms), the company has recently made considerable progress in Western European markets, exploiting the expired patents of internationally best-selling drugs.

Richter Gedeon



Rating history

Date	Rating	Price	Target Price
09. Jun 11	Buy	34605.00	45500.00
29. Jul 09	Accumulate	35550.00	41900.00
10. Aug 07	Buy	36250.00	46000.00
15. Feb 07	Accumulate	40700.00	46310.00
24. Oct 06	Hold	44000.00	45225.00
19. May 06	Accumulate	42700.00	49350.00
13. Jun 05	Hold	28920.00	29200.00
11. Nov 04	Buy	22400.00	26650.00
10. Nov 04	Accumulate	22400.00	29067.00
11. May 04	Buy	20115.00	26650.00
06. Aug 03	Accumulate	18100.00	19438.00

Company description

Richter Gedeon is Hungary's largest pharmaceutical exporter. Its niche portfolio strategy, with a focus on gynecological products, is bringing sizable gains in Western markets, namely the US (partnership with Teva / Barr Labs). Richter's traditionally strong position in Russia/CIS and CEE is another key asset of the company. Richter ranks among the most liquid shares on the BSE.

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Disclosure Checklist

Company	ISIN	Disclosure
Antibiotice	ROATBIACNOR9	
Biofarm	ROBIOFACNOR9	
Bioton	PLBIOTN00029	
Egis	HU0000053947	
Krka	SI0031102120	
Richter Gedeon	HU0000067624	

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Accumulate	+10% < target price < +20%
Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
Sell	< -10% to target price

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Distribution of ratings

	Coverage universe		Inv. banking-relationship	
Recommendation	**No.**	**in %**	**No.**	**in %**
Buy	67	37.4	19	39.6
Accumulate	42	23.5	11	22.9
Hold	44	24.6	13	27.1
Reduce	9	5.0	4	8.3
Sell	8	4.5	1	2.1
N.R./UND.REV./RESTR.	9	5.0	0	0.0
Total	**179**	**100.0**	**48**	**100.0**

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