

Erste Sector Healthcare

Pharma stocks remain on investment prescription list – July 28 2009

Upcoming reporting season anticipated to confirm solid pharma companies' performance, supported by Russian market pickup

Richter and Egis results to evidence pros and cons of forint swings

Despite 2Q rally, healthy prospects of CEE pharmas not adequately priced in

Richter and Krka keep their strategic competitive edge, Egis' valuation gap narrower, but still appealing, Bioton's restructuring story gaining attractiveness

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Executive summary

The CEE equity markets experienced a revival in 2Q, but a recovery of economic fundamentals will take more time and the optimism of market participants is likely to remain fragile in the coming periods. Along with the healing of the economy, the fresh fund inflows will remain the critical factor for a more sustainable upward trend on equity markets. On the other hand, we still see the continuing volatility creating interesting trading opportunities. The 1Q09 results demonstrated that pharma markets in the region still offer room for growth and that the impact of the economic slowdown on the pharmaceutical business is rather limited, with companies' managements gaining more confidence in providing 2009 guidance (which they were hesitant to disclose at the beginning of the year).

Although the general economic outlook is still not rosy, the wave of downgrading and slashing of economic growth forecasts (including those for key markets of CEE pharma players) is gradually diminishing. Restrained resources highlight generics as the best alternative for ever-more cost conscious health insurers and patients in both the East and West. While the regional currencies' weakening keeps a lid on sales growth, the grip has been easing already in 2Q09, bolstering CEE and Russian market fortunes of CEE-based pharmas. However, some earlier benefits from currency swings on the financial result were erased for Hungarian companies. Last but not least, government bond yields continued to head south, further increasing investors' appetite for stocks and boding well for valuations.

We reviewed our models and set new 12-month target prices for CEE pharma stocks. Although the currency push is set to gradually recede, the y/y picture remains more favorable from the exporters' perspective and Hungarian pharmas are poised to get help from the currency side to notch sound top line growth, as well as enjoy a bolstering effect on profitability margins this year. We adjust WACC rate assumptions in the DCF models for the Hungarian pharmas to reflect decreasing government bond yields. In summary, we fine-tune our target prices for Richter and Egis to HUF 41,900 per share and HUF 21,785 per share, respectively. We believe that, after their strong upward move (51.7% for Egis and 29.1% for Richter since our last report in May 2009), the stock price levels are still appealing from the long-term perspective. However, with respect to the narrowing difference to our (upwardly revised) target prices, we downgrade our recommendations for both Richter and Egis from Buy to Accumulate.

While Krka lacks the substantial currency cushion enjoyed by its Hungarian rivals in 2009, its business performance continues to outshine its regional peers. Krka's top line tempo in euro terms, as well as its profitability margins, continue to top the region's (and generics) pharma sector. Our revised target price of EUR 106.5 per share (excluding the beneficial impact from possible release of atorvastatin case related provisions) suggests that the stock price, despite the hefty gains in 2Q, still has solid upside potential, should it adequately reflect Krka's regional competitive edge. We confirm our Buy recommendation.

Bolstered by renewed investor hopes that the restructuring strategy presented by the new CEO, as well as the capital injection from its key shareholders, will finally bring a turnaround in the company's performance, Bioton's share price shrugged off worries related to disappointing 1Q09 figures. Adjusting our 12-month target price to incorporate the worse than expected 1Q09 results, another capital injection (reducing the debt pile, but bringing further dilution effects), Biferonex market entry delays as well as the Bayer deal's significant boost to the Chinese insulin market fortunes, yields a new target price of PLN 0.31 per share (vs. the earlier PLN 0.28). All told, we raise our recommendation from Reduce to Hold. As before, a potential upgrade hinges on the company's ability to deliver the first tangible results of its restructuring efforts.

While equity markets remain volatile, sentiment is gradually improving and we believe that the bottom has been reached already. While the increasing risk appetite will undoubtedly turn the attention of investors towards cyclical stocks in the coming periods, we think that pharma companies retain their appeal as safe haven investments and should keep their firm positions in investment portfolios. We believe that the upcoming 2Q reporting season will confirm that top CEE pharmas are well placed to weather the financial crisis, with generics remaining in high demand and sound balance sheets boding well for their investment plans. Consequently, we are convinced that the top CEE pharmas represent a sound long-term value-based investment and remain a healthy option for those wanting to play it safe and keep a longer-term horizon in mind.

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Valuation Summary

24/07/2009	Rep. Curr.	Mcap (EURmn)	Price Current (LC)	Price Target	Recommendation	Performance (EUR terms)			
Company						1M	3M	6M	12M
A&D Phama	EUR	69.3	2.1	2.9	Hold	5.1%	40.5%	-7.6%	-9.6%
Bioton	PLN	1,455.6	0.31	0.31	Hold	14.8%	3.3%	55.0%	-27.9%
Egis	HUF	143,724	18,460	21,785	Accumulate	6.1%	53.8%	51.7%	26.3%
Intercell	EUR	1,160.5	25.5	39.5	Buy	4.1%	15.5%	0.8%	-14.6%
Krka	EUR	2,477.0	69.9	106.5	Buy	2.8%	34.8%	29.9%	-25.1%
Richter Gedeon	HUF	687,723	36,900	41,900	Accumulate	12.5%	30.2%	24.7%	13.2%
Sanochemia	EUR	21.2	2.1	1.8	Reduce	17.4%	1.0%	-15.7%	-67.3%
Teva Pharmaceutical	ILS -	31,408	-	-	-	5.0%	7.0%	10.8%	20.4%
Mylan Inc.	USD	2,975	-	-	-	2.3%	-9.5%	13.0%	15.3%
Watson Pharmaceuticals	USD	2,563	-	-	-	2.4%	1.0%	21.8%	28.2%
Stada Arzneimittel AG	EUR	1,001	-	-	-	-2.4%	15.9%	-9.1%	-63.6%
Ranbaxy Laboratories	INR -	1,716	-	-	-	8.3%	53.3%	40.9%	-43.8%
Recordati	EUR	955	-	-	-	6.1%	5.8%	20.0%	-0.8%
Dr Reddy Laboratories	INR -	2,007	-	-	-	4.5%	42.2%	78.1%	24.2%

Source: Erste Group Research, Factset. Based on closing prices as of July 24, 2009

Valuation

Richter and Krka continue to top our recommendation list

The share prices of CEE pharma stocks enjoyed a nice recovery in 2Q09. It all came together: The top CEE pharma companies posted solid 1Q09 results. The market sentiment on global equity markets (with market participants assuming that the upcoming economic downturn had already punished equity markets sufficiently) helped also to change the stocks' performance trend. On top of that, both Egis and Richter, as companies based in Hungary (a country previously shunned by investors as one of the most problematic hot spots in the region), saw benefits from the stabilizing home country macroeconomic picture. Egis was finally uncovered by bargain hunters and its stock price, supported by strong 2Q08/09 figures, went skywards.

Bioton share price to be driven by restructuring news

A brief look at the current valuations demonstrates that, despite the appreciation, the key CEE pharma players' stock upside potential has yet to evaporate. As evidenced by 1Q09 developments, the home market of Richter and Egis does not represent reason for substantial worry, unlike in previous periods. While some pressures linked to changing the reimbursement regime for reimbursed drugs (decreasing the maximum subsidy to 80%, down from the earlier 85%, pushing up patients' co-payments) are palpable, the market is looking for a slow recovery from the earlier lows. Although the Hungarian currency's steep fall vs. the US dollar and euro has slowed down, for the full year, the forint is projected to be weaker, boding well for this year's export sales and profitability margins for both Hungarian pharmas (with significant shares of export revenues and the majority of costs incurred in HUF). All told, our new target prices (HUF 21,785 per share for Egis and HUF 41,900 per share for Richter) point to interesting upside potential. Nevertheless, with respect to their hefty recent gains, both stocks have approached our target prices. We thus cut our recommendations from Buy to Accumulate for both Egis and Richter. Given the steeper stock rally of Egis (making the stock prone to profit-taking), as well as Richter's long-term strategic edge, we stick to our stronger preference for the latter stock.

Unlike its Hungarian peers, Krka cannot expect to get backup from the currency side (rather the opposite) this year. Nevertheless, we believe (and interim 2009 data support this view) that the company's profitability margins and top line growth will remain superior, beating its regional rivals in 2009. The main prerequisite for this remains Krka's edge in bringing innovative (and highly priced) branded generics to both CEE and Western European markets. In its patent expiration exploitation strategy, the company has no parallel in the CEE pharma universe. With our newly updated target price arriving at EUR 106.5 (only slightly revised from the earlier target of EUR 105.0) per share, we stick to our Buy recommendation on the stock.

Factoring in the worse than anticipated 1Q09 results, along with the postponement of the Biferonex market launch and the dilutive effect from the recent additional capital injection, but improving long-term prospects in the core insulin business (in particular the profound impact of Bayer's deal on Bioton's Chinese market fortunes), our new 12-month target price for Bioton is PLN 0.31 per share, up from the earlier PLN 0.28. All told, we raise our recommendation from Reduce to Hold. Should the future outlook become rosier, with the company delivering the first tangible results of its rebound, we would consider a change of our recommendation.

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CEE pharmaceuticals valuation at a glance

	P/E				P/CE				P/BV			
	2007	2008	2009e	2010e	2007	2008	2009e	2010e	2007	2008	2009e	2010e
A&D Pharma	n.m.	n.m.	31.6	15.2	n.m.	12.0	6.4	4.9	2.1	0.3	0.3	0.3
Bioton	85.7	n.m.	n.m.	13.4	49.3	n.m.	n.m.	10.6	2.8	0.6	1.1	1.1
Egis	23.4	6.3	9.7	9.6	12.6	4.1	6.3	6.1	1.7	0.8	1.1	1.0
Intercell	218.5	67.6	101.6	28.4	162.3	57.5	82.8	26.5	4.7	3.5	3.6	3.2
Krka	33.2	11.0	15.1	12.6	20.9	7.3	10.3	8.9	6.6	2.2	2.7	2.3
Richter Gedeon	23.2	12.8	14.7	14.3	14.4	8.5	10.1	9.7	2.5	1.6	1.9	1.7
Sanochemia	n.m.	n.m.	n.m.	68.7	n.m.	64.4	11.6	3.8	1.8	0.9	0.4	0.4
Median CEE	33.2	11.9	15.1	14.3	20.9	10.3	10.2	8.9	2.5	0.9	1.1	1.1
Teva Pharmaceutical	21.7	17.1	14.7	11.3	23.6	14.2	14.0	10.8	3.1	2.5	2.5	2.0
Mylan Inc.	10.5	16.9	12.8	9.5	11.0	11.6	12.6	6.7	1.1	1.7	2.0	1.5
Watson Pharmaceuticals	25.9	16.6	14.1	13.7	8.8	10.6	10.3	9.7	2.0	1.9	1.7	1.5
Stada Arzneimittel AG	7.5	10.9	10.7	9.8	4.9	6.8	5.8	5.5	1.1	1.2	1.1	1.0
Ranbaxy Laboratories	12.2	n.a.	329.0	34.6	8.7	n.a.	n.a.	19.7	3.2	2.2	2.5	2.4
Recordati	11.0	9.5	8.8	10.2	8.2	7.1	6.9	7.9	2.4	2.1	1.9	1.8
Dr Reddy Laboratories	24.8	n.a.	17.7	15.2	17.1	18.2	12.0	11.7	2.5	3.3	2.9	2.5
Median Peer Group	12.2	16.6	14.1	11.3	8.8	11.1	11.2	9.7	2.4	2.1	2.0	1.8
EuroStoxx Healthcare	17.1	15.6	15.8	13.7	10.9	10.3	9.2	9.0	2.5	2.1	1.8	1.6
CEE to Peer, Prem/Disc	173%	-29%	7%	27%	138%	-8%	-9%	-9%	4%	-56%	-45%	-39%

	EV/Sales				EV/EBITDA				Dividend yield			
	2007	2008	2009e	2010e	2007	2008	2009e	2010e	2007	2008	2009e	2010e
A&D Pharma	1.3	0.2	0.2	0.2	46.7	4.7	4.0	3.8	0.7%	0.0%	0.6%	1.3%
Bioton	10.3	4.0	4.9	2.8	21.7	-24.6	102.5	8.2	0.0%	0.0%	0.0%	0.0%
Egis	1.8	0.8	1.1	1.0	11.8	4.6	5.4	4.8	0.5%	1.1%	0.7%	0.7%
Intercell	17.3	18.7	10.0	6.3	272.3	-96.5	71.9	18.3	0.0%	0.0%	0.0%	0.0%
Krka	5.8	2.0	2.6	2.3	18.9	6.2	8.2	7.3	0.7%	2.2%	1.6%	1.7%
Richter Gedeon	3.2	1.9	2.2	2.0	12.9	8.4	8.9	7.8	1.1%	2.1%	1.8%	1.9%
Sanochemia	2.8	1.6	0.7	0.7	-48.5	13.4	16.5	4.4	0.0%	0.0%	0.0%	0.0%
Median CEE	3.2	1.9	2.2	2.0	18.9	4.7	8.9	7.3	0.5%	0.0%	0.6%	0.7%
Teva Pharmaceutical	4.2	3.8	3.4	2.8	13.7	13.2	11.5	8.6	0.8%	0.9%	1.1%	1.2%
Mylan Inc.	3.4	1.6	1.9	1.7	11.9	7.8	7.7	6.3	1.2%	1.3%	0.0%	0.0%
Watson Pharmaceuticals	1.4	1.2	1.4	1.2	6.6	5.8	5.8	5.2	0.0%	0.0%	0.0%	0.0%
Stada Arzneimittel AG	2.2	1.3	1.2	1.2	10.8	8.7	7.4	6.9	4.2%	3.1%	3.2%	3.5%
Ranbaxy Laboratories	2.9	1.7	2.0	1.8	21.4	20.3	41.2	15.8	3.6%	2.9%	1.3%	1.8%
Recordati	2.2	1.3	1.3	1.4	8.7	5.1	5.4	5.8	4.7%	5.5%	5.5%	n.a.
Dr Reddy Laboratories	2.6	1.3	2.0	1.7	15.6	7.1	10.4	9.2	0.6%	0.8%	0.7%	0.8%
Median Peer Group	2.6	1.3	1.9	1.7	11.9	7.8	7.7	6.9	1.2%	1.3%	1.1%	1.2%
EuroStoxx Healthcare	3.0	2.2	2.1	2.0	11.7	9.2	9.1	8.4	1.8%	1.9%	2.1%	2.4%
CEE to Peer, Prem/Disc	24%	44%	19%	21%	59%	-40%	16%	6%	-56%	-100%	-43%	-46%

	EBITDA margin				Net margin				ROE			
	2007	2008	2009e	2010e	2007	2008	2009e	2010e	2007	2008	2009e	2010e
A&D Pharma	2.9%	4.4%	5.3%	5.6%	-2.0%	-0.5%	0.4%	0.8%	-3.2%	-1.0%	1.0%	2.0%
Bioton	47.5%	-16.3%	4.8%	34.7%	9.8%	-76.0%	-13.5%	19.7%	3.4%	-22%	-3.5%	8.0%
Egis	15.4%	16.7%	20.2%	20.5%	8.3%	14.5%	13.5%	13.3%	7.7%	12.8%	12.1%	11.0%
Intercell	6.4%	-19.4%	13.9%	34.4%	9.4%	30.8%	11.7%	26.6%	2.9%	5.7%	3.5%	11.9%
Krka	30.8%	32.5%	31.1%	31.3%	17.0%	16.4%	15.7%	16.8%	21.5%	21.5%	19.4%	19.8%
Richter Gedeon	25.2%	23.1%	25.2%	25.9%	15.2%	17.6%	17.9%	17.4%	11.2%	12.9%	13.2%	12.3%
Sanochemia	-5.7%	11.7%	4.3%	15.1%	-15.0%	-12.3%	-10.3%	0.7%	-7.6%	-6.2%	-5.7%	0.6%
Median CEE	15.4%	11.7%	13.9%	25.9%	9.4%	14.5%	11.7%	16.8%	3.4%	5.7%	3.5%	11.0%
Teva Pharmaceutical	31.0%	28.6%	29.7%	32.7%	20.7%	21.6%	20.8%	24.5%	14.4%	14.7%	17.2%	18.0%
Mylan Inc.	28.2%	20.1%	24.6%	26.4%	12.8%	4.8%	10.3%	11.9%	10.0%	10.0%	15.8%	15.9%
Watson Pharmaceuticals	21.4%	21.5%	23.6%	22.8%	5.6%	9.4%	10.3%	10.8%	7.6%	11.4%	12.1%	10.9%
Stada Arzneimittel AG	20.1%	15.6%	16.7%	17.0%	6.7%	4.6%	5.6%	6.1%	14.5%	11.1%	10.4%	10.7%
Ranbaxy Laboratories	13.5%	8.5%	4.9%	11.4%	11.4%	-12.7%	-1.1%	5.2%	26.2%	-3.8%	0.8%	7.0%
Recordati	25.1%	25.2%	24.7%	23.3%	13.5%	14.5%	14.0%	13.0%	22.1%	22.4%	21.4%	17.2%
Dr Reddy Laboratories	16.8%	18.7%	19.3%	18.9%	9.3%	-7.4%	10.7%	11.1%	9.9%	-11%	16.2%	16.4%
Median Peer Group	21.4%	20.1%	23.6%	22.8%	11.4%	4.8%	10.3%	11.1%	14.4%	11.1%	15.8%	15.9%
EuroStoxx Healthcare	20.0%	19.7%	19.8%	19.9%	7.7%	7.7%	7.8%	10.0%	13.8%	12.4%	12.4%	12.9%
CEE to Peer, ppt	-0.3	-0.4	-0.4	0.1	-0.2	2.1	0.1	0.5	-0.8	-0.5	-0.8	-0.3

Source: Erste Group Research, Factset. Based on closing prices as of July 24, 2009

Market overview

Global economic slowdown worries digested...

...increasing risk appetite and liquidity rise resulted in bear market rally in 2Q, including CEE markets

The first half developments confirmed that 2009 is set to be one of the most challenging years for equity markets in recent history. While the US and European governments' economic stimulus packages and bailouts of major financial institutions aimed at preventing deeper falls of shaken economies somewhat calmed the jittery markets, the real economy data released so far demonstrated the weakness of the macroeconomic environment and pointed to a long and potentially painful recovery road. There is no doubt that CEE economies are facing a period of recession, with negative GDP growth in 2009, to be followed by a slow revival or (even possibly) stagnation in 2010. The oversold equity markets have experienced a rally since March 2009, with risk appetite moving up to a certain degree and equity risk premiums returning closer to their historical averages. After a big double-digit slump in 2008, despite the 2Q09 hefty gains, the CEE equity market performance has still lagged behind other regions since the highs recorded in autumn 2007. The CEE region was paying a high price for the risk aversion among large institutional investors towards small illiquid stocks, after the redemption pressures emptied the emerging equity market funds and dampened trading volumes in already rather thin markets. CEE pharma stocks picked up quite solidly in 2Q, although on average their tempo lagged behind the banks and cyclicals, which (as the hardest hit) enjoyed the biggest short-run upside potential in the temporarily more optimistic environment. Still, with respect to the fragility of the economic conditions and heavy impact of the economic slowdown on cyclicals (to be demonstrated in the coming reporting season), the defensive nature of the pharma industry (one of the few poised to post a positive growth rate and facing only limited risks of downward forecasts revisions) should provide a solid shield from the still volatile CEE equity market conditions.

CEE pharma stocks have recently shown solid recovery

	LC terms				% Change YTD	EUR terms				% Change YTD
	% Change 3 Months as of 30/09/08	% Change 3 Months as of 31/12/08	% Change 3 Months as of 31/03/08	% Change 3 Months as of 30/06/09		% Change 3 Months as of 30/09/08	% Change 3 Months as of 31/12/08	% Change 3 Months as of 31/03/08	% Change 3 Months as of 30/06/09	
Bion S. A.	-11.5%	-56.5%	10.0%	18.2%	55.0%	-12.5%	-64.2%	-3.1%	23.7%	52.1%
WIG 20 Bench (PL)	-8.0%	-24.9%	-15.5%	23.2%	16.4%	-9.0%	-38.2%	-25.6%	29.0%	14.2%
Egis Plc	-25.4%	-11.3%	13.7%	53.9%	84.6%	-27.5%	-19.3%	-2.0%	74.2%	83.4%
Richter Gedeon	-3.6%	-8.8%	-11.1%	37.8%	29.9%	-6.3%	-17.0%	-23.4%	56.0%	29.1%
BUX Bench (HU)	-8.8%	-35.1%	-9.6%	34.9%	32.1%	-11.3%	-41.0%	-22.1%	52.8%	31.2%
Krka	-16.9%	-35.1%	9.0%	32.9%	44.9%	-16.9%	-35.1%	9.0%	32.9%	44.9%
SBI Bench (SI)	-21.8%	-38.6%	-3.3%	17.6%	12.2%	-21.8%	-38.6%	-3.3%	17.6%	12.2%

Source: Erste Group Research

CEE pharmas outperformed their home markets, posting convincing gains ...

... Bion shrugged off bad results, propelled by hopes of turnaround brought by new strategy

Aside from the sound 1Q09 results reported by major CEE pharmas, the switching market sentiment helped to lift share prices in 2Q09. CEE pharmas' stock price performances since the beginning the year remain in positive territory, with gains by Hungarian stocks expressed in euro terms further buoyed by the firming of the Hungarian forint vs. the euro. Although the reversing fortunes of the forint (gaining ground vs. the euro and the US dollar) will undoubtedly take a toll on the coming periods' financial results for Hungarian pharmas, the positive effects from the regional currencies' appreciation will help the top line, stabilizing business in the markets suffering most from the steep 1Q09 currency fall. While benefits for Richter and Egis from the weaker forint (and harm from strengthening) are undeniable, investors seem to be less sensitive to currency swings than in the past, and the share price performance-forint correlation of Richter and Egis is becoming minimal these days. Investors welcome the firming forint as a sign of a stabilizing Hungarian economy, and the possible increasing weight of Hungary in investors' portfolios plays in favor of both Richter and Egis. Bion's share price ignored the bad interim results and investors focused instead on future hopes attached to the new strategy and positive impact of the capital injections on reducing Bion's debt pile. We assume that the scenario will be the same in coming months as well, with the company expected to conclude more restructuring deals this year (with the disposal of Bion Wostok topping the agenda at the moment).

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Despite recent gains, CEE pharmas offer attractive upside potential

Company	Currency	Current Price (LC)	52 wk high (LC)	Current price vs 52wkh (%)	Target price (LC)	Upside potential (%)
Krka	EUR	69.9	95.0	-26.4%	106.5	52.3%
Richter Gedeon	HUF	36,900	37,355	-1.2%	41,900	13.6%
Egis	HUF	18,460	18,980	-2.7%	21,785	18.0%
Bioton	PLN	0.31	0.51	-39.2%	0.31	0.0%

Based on closing prices as of July 24, 2009; Source: Erste Group Research

CEE pharma markets offer solid long-term growth prospects...

...although tempo in short run will be somewhat compromised

The 2009 interim results of the CEE-based pharmaceutical companies confirmed that pharma markets remain resilient to the recession. Although the growth tempo was tempered to a single-digit pace (and in euro terms it slipped in certain markets to negative territory), the outlook is far from gloomy. The aging population and broadening availability of more modern therapies, as well as Rx to OTC and specialist to GP prescription switches, will keep their position as main pharma market drivers and largely compensate for the temporarily less favorable economic conditions (reducing disposable income of patients and further intensifying cost containment measures of health insurers) in the coming period. We continue to believe that, despite the slowing economic growth, the CEE pharmaceutical markets should see a rise, while the catch-up effect in narrowing the gap in healthcare (and drug) spending between the CEE region and the EU-15 average is still in place in the long run. Although the generally worsening macroeconomic conditions call for harsher savings measures, the pressure from health insurers on reimbursed drug prices is nothing new for the pharma industry. As before, generics companies will be less affected, as original drug manufacturers will have more difficulties coping with stricter reimbursement limits, with consumer and insurer preferences shifting even more than before to affordable generics. In order to defend their profitability margins, CEE pharma companies have no choice but to continue to focus on fast innovation of their product portfolios, expanding the share of new products, typically offering higher margins, in their sales structure. Apart from more active portfolio and product cycle management, the companies have to watch their costs more carefully. The lower inflationary pressures in the recession period promise to provide partial relief in this respect, trimming commodity prices and tempering the rise in personnel costs, as well as other inflation linked operating expenses.

Generics to keep their dominance in CEE, boding well for CEE-based pharma producers...

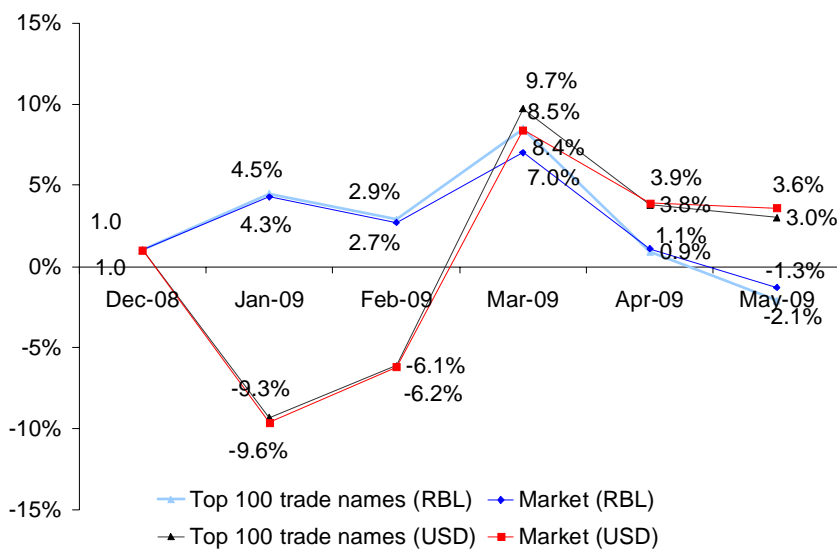
While the economic depression is prompting health insurers to tighten their belts, including further reduction of spending on reimbursed drugs, the more complex healthcare reforms (given their political sensitivity) remain on hold in CEE countries. The healthcare reform package introduced by the Czech government from January 2008 (involving payments for doctor visits, drug prescriptions and hospital stays) was one of the reasons for the fall of the government. As a result, some of the reform elements were abolished. Still, the pressure continues, namely via a strict application of the drug reimbursement limits tied to the cheapest reference product. Similarly, in Hungary, the quarterly revisions have led to gradual lowering of reference prices, with necessary price adjustments to be done by pharma manufacturers wanting to keep the reimbursement status of their products and hence their sales prospects untouched. Here, there is at least a change for the better, as - based on the newly introduced legislation - the maximum limit for a difference between the price of the product retaining its reimbursement status and the reference drug was moved from 120% to 130%. The cut in the highest reimbursement category limit from an 85% reimbursement level to 80%, with the difference to be covered by patients (introduced from April 2009), seemingly did not have any major impact on consumption, as the relevant categories include vitally important drugs for chronically ill people (cardiovascular and CNS products) that are difficult to replace. In addition, the weak forint made exports of foreign manufacturers to Hungary less attractive this year, speaking in favor of the domestic manufacturers' position. Other recent developments on the regulatory front in Hungary look rather positive as well. The Hungarian government prepared a program supporting the R&D-oriented pharmaceutical industry. The plan includes tax allowances, supported R&D locations, natural science studies and easing restrictions on drug consumption. While details are only to be officially announced in autumn this year, the first revealed steps include the possibility for drug producers to reduce their payments (stemming from a 12% drug subsidy rebate and fees for sales representatives) by 20% in the first year and then by up to 100% if they spend the saved

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amount on research and development activities. With respect to their sizable R&D budgets, both Richter and Egis would be able to take full advantage of the program and reduce their costs. (In 2008, the OEP related payments totaled HUF 1.9bn for Richter; Egis paid some HUF 2bn for the same purpose in the 2007/08 fiscal year.)

The changing market environment in Hungary, with the country no longer seen as the most troublesome among the CEE pharma markets, is evidenced in new guidance by Hungarian pharma companies. After publishing its 2008 report, Richter refrained from providing any guidance, but in May the company stated its 2009 goals, projecting its Hungarian market sales stopping their fall and stabilizing y/y in 2009. Moreover, Egis recently raised its domestic targets for the coming years significantly, envisaging that its domestic sales tempo will pick up from low single-digit terms (by some 2% y/y) in the current fiscal year 2008/09 to around 8% y/y in 2009/10, calling for an upward revision of our forecasts.

Changes in prices of drugs on the Russian commercial pharmacy market, December 2008- May 2009



Source: DSM Group

Russia / CIS remains another closely followed market for CEE-based pharmaceutical companies. The 2009 developments in Russia and other post-Soviet countries (Ukraine, Kazakhstan, etc.) demonstrate the critical role of local currencies' sharp depreciation. As the corresponding price hike at the pharmacy level would be too difficult for patients to fully absorb, wholesalers (caught in the middle) pushed CEE-based Russia/CIS players to share at least partly the currency related burden. With contracts with CEE pharma manufacturers fixed in US dollars and euro, they asked for either higher discounts or lower prices. In order to keep business running without bigger interruptions, most of the CEE pharma companies opted for higher discounts (related to the forex rate) for their partners, while extending credit terms to the reliable ones. Consequently, in 1Q09, the sales performance of key CEE-based pharma players in Russia was solid, with a 14% y/y sales rise reported by Krka (in EUR terms) and a 14.7% y/y tempo posted by Egis (in USD terms). Only Richter's performance (a sales drop of 16.4% y/y in euro terms) was somewhat lackluster, reflecting the year-earlier high comparative base, as well as relatively late term for reaching the relevant agreement with wholesalers on the new contract terms. According to DSM Group data, the Russian pharmaceutical market advanced by a hefty 30% y/y in ruble terms to RBL 141bn in the first six months of 2009. At the same time the market contracted in volume terms by 6% y/y. The price index in June 2009 compared to January 2009 stood at +15.4%. While prices of imported medicaments increased by 17.5% y/y, prices of domestically produced drugs went up by 9.1% y/y in January – June 2009 period. Going forward, apart from the general economic environment, possible regulatory changes (with price monitoring introduced in May 2009 seen as the first step in the stricter - and in practice enforced - price regulation of reimbursed drugs) will remain in focus. At the moment, CEE companies are oriented primarily to the private segment, so the tougher rules do not seem to endanger their position. Furthermore, the main addressee of the newly introduced price caps will be

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wholesalers and retailers, given the high value and striking difference in markups, which are not fully justifiable by logistics costs. (Wholesale markups are currently reportedly ranging from 15% to 60%, while retail pharmacy markups reach from 15% to 100%.) Currency remains an important factor for the business performance of exporters to the Russian pharma market as well. Here it was encouraging to see that the ruble stopped its fall in 2Q09, boding well for diminishing forex related discounts provided by CEE companies to their wholesale partners in Russia. While achieving sales growth in Russia is a realistic target for CEE producers, despite the crisis; the burden of the economic slowdown and forex situation is much heavier in Ukraine. Although the situation stabilized there in the second quarter, all CEE-based pharma companies have to calculate with a Ukrainian sales decline in their 2009 projections.

... with changing regional currency situation and fine-tuning of risk-free rates (reflecting moves in government bond yields) to be incorporated into our models

Since the publication of our last pharma sector report in May 2009, interest rates in major world economies were kept rather steady, as the historically extremely low levels (with the US Federal Reserve slashing its key interest rate to the unprecedented range of zero to 0.25% and the European Central Bank decreasing its interest rate to 1.0%) did not provide much room for further cuts. The same holds for CEE countries, the home markets of CEE pharma companies. The external indebtedness of CEE pharma companies is minimal and they can finance their investment plans without tapping financial markets. Consequently, they are not negatively hit by the still tight availability of credit resources. Thus, the main factors to be reconsidered in our models are the applied equity risk premiums and risk-free rates, as well as changing currency outlooks.

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 last pharma sector report in May, remains unchanged. In summary: 4.5% is used as a base equity risk premium (mirroring the long-term outperformance of stocks vs. bonds), 25bps is added for each rating notch below AAA and 40bps is added for each rating notch below investment grade (i.e. below BBB-). For perpetuity, extra charges are trimmed to 20bps and 35bps, respectively (while still based on the current rating). As before, the application of the methodology punishes to a certain extent the two Hungarian companies, with the resulting equity risk premium well above other regional peers, particularly Krka.

While the situation continues to vary from country to country, despite the 2Q appreciation, CEE currencies remain y/y weaker vs. the euro (and US dollar), boding well for heavily export-gearred pharmaceutical companies. Although the depreciation of the forint was somewhat less steep than we expected at the time of our last sector report (May 2009), prompting us to adjust our currency forecasts for 2009 and coming periods for Richter and Egis, both companies should be able to benefit from the y/y weaker forint in 2009. In addition, one has to bear in mind the positive effect of the recent regional currencies' appreciation and stabilization on top line developments, as sales of Richter, Egis and Krka in certain CEE markets are invoiced in local currencies. Importantly, all of the CEE-based Russian market players benefited from the ruble stabilization (and even slight q/q appreciation) in 2Q09, helping to bring business conditions there to a normal level and reducing the need for the previously applied special forex related discounts to their wholesale partners in Russia.

CEE currencies vs. US dollar, euro in 2Q09

	2Q08 average USD	2Q08 average EUR	2Q09 average USD	2Q09 average EUR	2Q 09 y/y USD	2Q 09 y/y EUR	2Q09 vs 1Q09 USD	2Q09 vs 1Q09 EUR
Hungarian forint	158.6	247.9	210.2	285.9	-24.5%	-13.3%	7.6%	2.9%
Czech crown	15.9	24.8	19.6	26.7	-18.9%	-6.9%	8.2%	3.5%
Polish zloty	2.2	3.4	3.3	4.4	-33.2%	-23.3%	5.6%	1.1%
Romanian leu	2.3	3.7	3.1	4.2	-24.1%	-12.9%	6.5%	1.8%
Russian rouble	23.6	36.9	32.2	43.8	-26.6%	-15.7%	5.3%	1.4%
Ukrainian hryvnia	496.3	775.2	765.6	1,041.2	-35.2%	-25.5%	0.6%	-3.3%

Source: Erste Group Research, national banks' statistics

2Q09 results preview**CEE pharmas reporting schedule**

Date	Company	Release / event
30.7.2009	Krka	1H2009 results
5.8.2009	Egis	1-3Q2008/09 results
mid of August 2009	Richter Gedeon	1H2009 results
31.8.2009	Bioton	1H2009 results

Source: Erste Group Research, Company data

2Q09 results anticipated to be solid; bolstering effect of the y/y local currencies' depreciation to further support sound tempo in export markets

Egis: Egis is scheduled to announce its 3Q08/09 report on August 5 after the market close. Witnessing the bolstering effect from the y/y weakening of the Hungarian forint, as well as stabilization of the Hungarian pharma market, Egis's 3Q08/09 top line is envisaged to rise by a hefty 17.2% y/y to HUF 26,952mn. Helped further by the more favorable sales mix (with shrinking bulk chemicals sales), the company is anticipated to deliver a bold move on the operating line (up 83.7% y/y to HUF 3,757mn). Unfortunately, with the end-period closing exchange rate far less favorable than in the previous period, the operating profitability gains will be erased by the financial result. All told, we forecast a 12.4% y/y drop in net profit to HUF 1,954mn in 3Q08/09.

Richter Gedeon: As per tradition, the company did not disclose the exact date for publication of its 2Q2009 figures; it is expected that it will deliver them in the second week of August. We project Richter's consolidated sales advancing by a sound 24.4% y/y to HUF 71,909mn, lifting the 1H09 sales figure to HUF 133,247mn, up by 16.0% y/y. The recovering Russian and still buoyant US sales (benefiting from the drospirenone profit sharing agreement) are expected to offset sluggish sales in certain export markets (e.g. EU-15, with sales hampered by mounting generics competition). Although the currency developments in 2Q will take their toll on the financial result, the year-earlier low comparative base still speaks in favor of a relatively big y/y jump on the bottom line in the period. We forecast net profit soaring 116.5% y/y to HUF 6,307mn in 2Q09, bringing the 1H09 net profit to HUF 27,879mn, up 112.3% y/y.

Krka: Krka's 1H2009 report is scheduled for release on July 30, after market close. As Krka published its consolidated sales highlights (consolidated sales of EUR 477.9mn, up 2% y/y) at the beginning of July, the full report is not envisaged to bring any surprises on the top line. Performance in the key prescription pharmaceutical business remained healthy. Sales in CEE markets and Russia sustained their double-digit tempo, while Southeast Europe remained the laggard. Factoring in the excellent 1Q gross and operating profitability parameters, persistent (albeit slightly receding in 2Q) pressures from the strength of the euro vs. regional currencies, we forecast Krka's operating profit up 6.4% y/y to EUR 115.4mn and net income nearly flat y/y at EUR 77.5mn in 1H2009.

Bioton: Bioton's 1H2009 results are due on August 31. The consolidation of MJ Bioton Life Sciences and the two Italian companies is anticipated to largely counterbalance the lack of milestone payments (in 1Q08 amounting to PLN 24.8mn) on the top line. Consequently, we project Bioton's sales retreating only marginally y/y to PLN 163.4mn (vs PLN 165.8mn posted in 1H08). Reflecting the suboptimal profitability of the Italian companies and the absence of milestone payment income and still high cost base (in particular, at the foreign subsidiaries), we forecast the company's operating result staying in red numbers both in the second quarter and in 1H09, at losses of PLN 5.0mn and PLN 11.5mn, respectively. While the financial result is poised to see an improvement in 2Q (helped by the q/q more favorable forex situation), it will likely stay deeply in negative territory. All told, we envisage Bioton's 1H2009 bottom line to be painted in red; we forecast a net loss of PLN 34.0mn (out of which the second quarter is projected to add a PLN 14.3mn loss).

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2Q09 results preview summary

Bioton

IFRS consolidated	2Q2009	2Q 2008	y/y	1H2009	1H 2008	y/y
Total sales (PLN 000)	89,789	75,022	19.7%	163,364	165,751	-1.4%
Operating profit (PLN 000)	-5,043	-15,143	-66.7%	-11,521	23,706	-148.6%
Net income (PLN 000)	-14,313	-23,054	-37.9%	-34,050	-18,298	86.1%
<i>Operating margin</i>	-5.6%	-20.2%		-7.1%	14.3%	
<i>Net margin</i>	-15.9%	-30.7%		-20.8%	-11.0%	

Egis

IFRS nonconsolidated	3Q 08/09	3Q 07/08	y/y	1-3Q 2008/09	1-3Q 2007/08	y/y
Net sales (HUF mn)	26,952	23,000	17.2%	82,336	71,733	14.8%
Operating profit (HUF mn)	3,757	2,045	83.7%	12,133	6,910	75.6%
Net income (HUF mn)	1,954	2,231	-12.4%	12,714	8,076	57.4%
<i>Operating margin</i>	13.9%	8.9%		14.7%	9.6%	
<i>Net margin</i>	7.3%	9.7%		15.4%	11.3%	

Krka

IFRS consolidated	2Q 2009	2Q 2008	y/y	1H 2009	1H 2008	y/y
Total sales (EUR 000)	232,725	224,884	3.5%	477,911	469,268	1.8%
Operating profit (EUR 000)	47,947	45,734	4.8%	115,407	108,478	6.4%
Net income (EUR 000)	33,668	34,226	-1.6%	77,535	78,290	-1.0%
<i>Operating margin</i>	20.6%	20.3%		24.1%	23.1%	
<i>Net margin</i>	14.5%	15.2%		16.2%	16.7%	

Richter

IFRS consolidated	2Q2009	2Q2008	y/y	1H 2009	1H 2008	y/y
Total sales (HUF mn)	71,909	57,808	24.4%	133,247	114,834	16.0%
Operating profit (HUF mn)	14,733	9,182	60.5%	27,170	19,278	40.9%
Net income (HUF mn)	6,307	2,913	116.5%	27,879	13,134	112.3%
<i>Operating margin</i>	20.5%	15.9%		20.4%	16.8%	
<i>Net margin</i>	8.8%	5.0%		20.9%	11.4%	

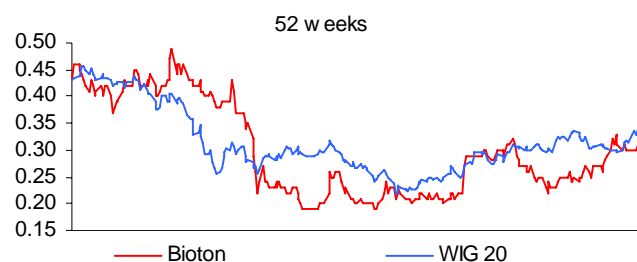
Source: Erste Group Research

Bioton

from Reduce to Hold

Vladimira Urbankova, MBA +43 50100 17343 vladimira.urbankova@erstegroup.com

PLN mn	2008	2009e	2010e	2011e
Net sales	293.5	332.6	540.9	546.1
EBITDA	-47.8	15.9	187.9	131.8
EBIT	-71.5	-11.7	159.0	101.3
Net result after min.	-218.9	-42.9	108.6	65.5
EPS (PLN)	-0.07	-0.01	0.02	0.01
CEPS (PLN)	-0.07	-0.00	0.03	0.02
BVPS (PLN)	0.36	0.28	0.29	0.31
Div./share (PLN)	0.00	0.00	0.00	0.00
EV/EBITDA (x)	-24.6	102.5	8.2	11.2
P/E (x)	-2.7	-33.9	13.4	22.2
P/CE (x)	-3.1	-95.5	10.6	15.2
Dividend Yield	0.0%	0.0%	0.0%	0.0%



Performance	12M	6M	3M	1M
in PLN	-27.9%	55.0%	3.3%	14.8%
in EUR	-44.6%	63.4%	10.4%	23.5%

Share price (PLN)	0.31	Reuters	BOTN.WA	Free float	56.8%
Number of shares (mn)	4,695.4	Bloomberg	BIO PV	Shareholders	Prokom Investment (22.9%)
Market capitalization (PLN mn / EUR mn)	1,456 / 347	Div. Ex-date			Polaris Finance (6.88%)
Enterprise value (PLN mn / EUR mn)	1,634 / 389	Target price	0.31	Homepage:	www.bioton.pl

Driven by fresh capital, restructuring hopes

- **Bioton's long-term prospects have become brighter recently. The fresh capital injections demonstrated further commitment of the key shareholders to the company, as well as their trust in the restructuring program initiated by the new management. The company aims to solidify its position in its core insulin business, with expansion planned in China to get a significant boost from a cooperation deal with Bayer. Helped by positive news flow, the stock was already able to shrug off the worries related to its disastrous 2008 and 1Q09 figures. Our 12M DCF-derived target price is PLN 0.31 per share (vs. the earlier target of PLN 0.28), suggesting that at the current price more or less adequately balances the enhanced prospects with persisting risks. Consequently, we upgrade our recommendation from Reduce to Hold.**
- **We incorporated into our model 1) the additional round of the capital increase, which brings a dilution effect to valuation multiples, but positively affects the financial position of the company; 2) the significantly greater than earlier anticipated burden of the foreign operations on both the operating and financial result sides; 3) the positive impact of the Bayer cooperation contract, assumed to kick in from 2010; 4) the negative short-term effect from postponements in the Biferonex project. Here, we want to emphasize that, given the lack of information, our projections currently do not include any future restructuring steps (most importantly, the disposal of unprofitable foreign operations). All told, with respect to the sluggish 1Q09 figures and delays in the Biferonex market launch, we cut our sales target for 2009 to PLN 332.6mn and reduce our bottom line forecast to a net loss of PLN 42.9mn.**
- **We expect the 1H09 results (scheduled for release on August 31) to witness the meager profitability of the company's operations. Reflecting the year-earlier high comparative base (with the top and operating lines boosted by milestone payments), as well as the relatively weak 1Q09 showing, we forecast Bioton's sales retreating by about 1.4% y/y to PLN 163.4mn and EBIT slipping to a loss of PLN 11.5mn in 1H09. The bottom line is expected to stay in red territory in 1H09 (we forecast a net loss of PLN 34.0mn).**

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Changes in forecast/outlook

Reflecting bleak outlook in Russia and postponements in Biferonex approval, we cut our 2009 sales target to PLN 332.6mn

The 1Q09 results provided further evidence that the quarterly picture remains very uneven, subject to the fluctuating appearance of one-off items. Moreover, the company's tender-driven insulin business in Russia is highly irregular, with practically no Russian insulin sales recorded in some quarters. On the positive side, the company enjoyed the first-time consolidation effect (Pharmatex, Fisiopharma and MJ Bioton Life Sciences) on its sales in 1Q09. Although y/y the zloty weakening vs. the USD (and euro) should continue to work in the company's favor, its impact on the overall sales results will be somewhat mitigated by the dampened export prospects to certain markets this year (most importantly, exports to the Russian pharmaceutical market are suffering from sharp ruble depreciation). Furthermore, while we continue to believe that Russia represents an attractive market for insulin manufacturers, Bioton's fortunes there now largely depend on the successful closing of the disposal of its stake in its Russian JV, Bioton Wostok, including finding a suitable cooperation partner for insulin sales and distribution. Consequently, while we still lack more details about the prepared deal, we opt to cut our forecasts and envisage Bioton's sales in Russia at a mere USD 3.6mn (down from the USD 5.8mn revised target) in 2009. In total, we expect Bioton's 2009 insulin sales to reach PLN 114.5mn, out of which the domestic market is projected to contribute PLN 68.6mn. On the other hand, the recently inked cooperation with Germany's Bayer provides a reason for cautious optimism going forward. According to the contract (valid until 2015), Bioton will supply its partner with insulin for the Chinese market. For the exclusive right to market and distribute insulin produced by Bioton under the trade name SciLin in China, Bayer will also make an upfront payment of EUR 31mn. The first insulin deliveries are anticipated in mid-2010. According to Bioton, the total value of revenues related to the Bayer contract over the 15 years is anticipated in the range of USD 1.5bn to USD 2bn. For the time being, we remain on the conservative side and envisage the company's total insulin sales exceeding PLN 149mn in 2010, out of which PLN 40mn is to be added by the newly signed contract with Bayer. For 2011, we project Bioton's insulin sales enjoying a bigger injection of around PLN 139mn from the deal and we lift our insulin sales forecasts here to PLN 285mn. (Here we want to highlight that, based on the latest information from the company, the EUR 31.0mn milestone payment from the Bayer contract is likely to be recorded under restricted cash and will not affect the company's P&L statement this year. Hence, for the time being, we assume that the milestone payment will give a boost to Bioton's revenues only in 2010.)

As consolidating the two Italian companies (Pharmatex Italia and Fisiopharma) started only in 2Q08, 2009 (as the first full year of consolidation) should see a positive impact from these acquisitions. Reflecting the updated company guidance, we assume that both Italian companies should together with MJ Bioton Life Sciences bring in total sales of around PLN 76mn in sales in 2009. The milestone payment related to the Biferonex regulatory approval by EMEA was seen as the crucial factor for the y/y progress in 2009. Although the green light was not granted as originally anticipated in February 2009, the company had believed that the delay would not be significant and it requested a re-examination of the opinion. However, at the end of May 2009, BioPartners, Bioton's subsidiary, withdrew its application for Biferonex at the EMEA, dampening any hopes of the related milestone payments this year. While the withdrawal does not prejudice the possibility of the company making a new application at a later stage, as we were informed, the company would currently rather investigate possibilities for submitting applications for marketing authorization for Biferonex in markets outside the EU. As a result, we are prompted to remove the attached boost to the top line from our 2009 projections. Furthermore, with respect to the likely lower payment (should the deal relate only to markets outside the EU), we opt to cut the envisaged milestone payment from the originally assumed PLN 70mn to PLN 35mn (expected to enrich the top line in 2010).

In summary, incorporating the latest developments, we trim our 2009 sales forecast from PLN 392.2mn to PLN 332.6mn for 2009, corresponding to a 13.3% y/y rise. Reflecting the Biferonex project changes, as well as the push provided by the Bayer contract (including milestone payment) to insulin sales in China, we raise our 2010 top line target to PLN 540.9mn (up from PLN 357.6mn projected earlier).

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As meager profitability of foreign operations continues to weigh on profitability margins, we cut our 2009 EBIT target to a loss of PLN 11.7mn

Restructuring efforts to bear more fruit from 2010 onwards

The interim results show clearly that the two Italian companies and MJ Bioton Life Sciences (all newly consolidated from 2Q08) proved (similarly to the earlier acquired BioPartners and SciGen) to put a lid on Bioton's profitability. Hence, it is not surprising that the streamlining of operations, including a possible disposal of foreign assets, is one of the restructuring steps of the company's new strategy, presented in May 2009. The first deal on the agenda is the sale of Bioton's stake in Bioton Wostok (after delays – it was expected to be finalized in June – the closing is now envisaged for the turn of July and August). On top of that, Bioton is also considering selling the factory in India. Here, the decision has not been taken yet, as the company is weighing its options, which range from a purchase offer to forming a joint venture, which would preserve this production site for Bioton. The Indian facility is 85% complete, but still needs a couple of million dollars to be finished. Another asset on the selling block is the HBV factory in Israel (similarly to the Indian facility owned by Bioton subsidiary SciGen). The company is holding talks with potential buyers, including one global player, but no decision was taken yet and the sale is not anticipated to take place this year. The Italian companies, Fisiopharma and Pharmatex, could also be disposed of, as their business activities (manufacturing and trade in injectable drugs sold primarily to hospitals) do not fit into the newly streamlined Bioton company profile. Moreover, due to significant delays in payment from their customers, they represent a hampering factor for Bioton's profitability. It is clear that Bioton's shape is currently undergoing significant changes, making an accurate forecast very difficult for the time being. At the moment, we lack information about the above-mentioned potential transactions (including their timing and likely proceeds), so we stick to our basic scenario for Bioton, keeping its current status quo in our forecasts. The only transaction reflected at least partly in our assumptions is the disposal of Bioton Wostok. In line with the company's guidance, we assume that (after a big cleanup of the 2008 balance sheet), it will be neutral for the consolidated P&L statement. (Some small forex and working capital calculation adjustments could be still accounted for.) Going forward, the losses from the share of equities accounted for with the equity method should diminish.

Summary of changes to 2009 and 2010 forecasts

PLN mn	2009 orig. forecast		2009 new forecast		2010 orig. forecast		2010 new forecast	
Net sales	392.2	100.0%	332.6	100.0%	357.6	100.0%	540.9	100.0%
Costs of good sold	180.1	45.9%	201.3	60.5%	166.6	46.6%	203.4	37.6%
Gross profit	212.1	54.1%	131.3	39.5%	191.0	53.4%	337.5	62.4%
Sales & marketing expenses	63.7	16.3%	54.9	16.5%	64.4	18.0%	70.3	13.0%
General & admin.expenses	72.6	18.5%	74.8	22.5%	64.4	18.0%	89.2	16.5%
Other operating income	15.7	4.0%	15.0	4.5%	14.3	4.0%	16.2	3.0%
Other operating expenses	14.7	3.8%	28.3	8.5%	12.5	3.5%	35.2	6.5%
EBIT	76.8	19.6%	-11.7	-3.5%	64.0	17.9%	159.0	29.4%
Financial result	-71.5	-18.2%	-43.8	-13.2%	-46.2	-12.9%	-27.3	-5.0%
Pre-tax profit	5.3	1.4%	-55.5	-16.7%	17.8	5.0%	131.7	24.3%
Income taxes	1.0	0.3%	-10.5	-3.2%	3.4	0.9%	25.0	4.6%
Minority interest	2.1	0.5%	2.1	0.6%	2.0	0.6%	2.0	0.4%
Net income after min. interest	6.4	1.6%	-42.9	-12.9%	16.4	4.6%	108.6	20.1%

Source: Erste Group Research

The Biferonex-linked milestone payments (recorded as part of revenues and envisaged to amount to PLN 70mn) were anticipated to save the show in 2009. Unfortunately, the likelihood of such a payment this year is practically zero, forcing us to drastically slash our profitability margin assumptions for 2009. Reflecting the still very meager gross profitability in 1Q09 (gross margin of just 36.2%), we made another cut in our 2009 gross margin target, from 54.1% to 39.5%. With help from some restructuring gain related effects and Bayer deal (as well as possible Biferonex) milestone payments kicking in next year, we see a significant improvement in the 2010 gross margin (to 62.4%) as achievable. With 1Q09 operating expenses higher than envisaged, we adjust our operating cost assumptions for 2009. In particular, factoring in the relatively high burden of foreign subsidiaries (and severance payments linked to personnel cuts), we raise our administrative and general costs forecast from PLN 72.6mn to PLN 74.8mn. (Only in its Polish operations does the company aim to reduce headcount, in this case by 170 people, or by some 27%, with related severance payments starting to burden its results from 2Q09.) Sales and marketing spending was rather modest in 1Q09. Hence, we opt for a minor cut to our

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assumptions for 2009 and envisage sales and marketing costs at around PLN 54.9mn, or 16.5% of sales. In summary, our new 2009 operating profit target arrives at a loss of PLN 11.7mn (down from the PLN 76.8mn operating profit projected earlier), translating into an operating profit margin of a negative 3.5% (down from the previous +19.6% forecast). For 2010, we continue to envisage a sizable increase in the sales and marketing costs, reflecting more intense marketing efforts in the core insulin business. While the area of general and administrative expenses offers substantial room for cost savings, the progress here will undoubtedly depend on the pace of restructuring – namely, the disposal of foreign operations and staff cuts. For the time being, we stick to our conservative approach and assume general and administrative costs to rise by some 19% y/y to PLN 89.2mn, or around 16.5% of sales. All told, for 2010, bolstered by a milestone payment-attributable cushion, we envisage a bold y/y improvement in operating profitability, with the EBIT margin climbing to 29.4%. Although we cannot rule out that restructuring gains will kick in more quickly or some of the above-mentioned transactions will provide relief to the ailing operating profitability margin, we set a new operating profit target at PLN 159.0mn (up from the previous forecast of PLN 64.0mn) for 2010.

Despite y/y improvement, financial result to weigh on bottom line; we forecast net loss of PLN 42.9mn for 2009

Contrary to earlier expectations, the company's financial result got out of red territory in 1Q09. The main reason was the hefty gain (of PLN 31.6mn) on the disposal of Bioton's stake in HTL-Strefa. On the other hand, the losses at foreign subsidiaries (amounting to PLN 16mn in 1Q09) surpassed our forecast and, despite the planned restructuring actions, continue to endanger the 2009 financial result. Although part of the financial expenses remain difficult to predict (in particular, forex and possible investment revaluation related losses), the improving financial position of the company after the recently concluded capital increase (with total net proceeds of PLN 277.1mn), as well as additional cash injection (a capital increase worth PLN 50mn by Ryszard Krauze), lead us to believe that the overall 2009 financial result is poised to turn for the better, compared to the disastrous 2008 performance. We trim our 2009 forecast to a financial loss of PLN 43.8mn, a significantly better outcome than the earlier anticipated financial loss of PLN 71.5mn. All told, in the absence of the earlier assumed milestone payment, supporting the still otherwise subdued operating profitability, we believe that the company will be unable to switch to black territory on the bottom line this year, although its net loss should shrink significantly y/y, with a net loss of PLN 42.9mn in 2009 (this compares to our earlier forecast of a net profit of PLN 6.4mn and the 2008 net loss of PLN 218.9mn). For 2010, we remain optimistic and, assuming a bolstering effect of milestone payments, we project net profit advancing to PLN 108.6mn.

1H09 results preview

IFRS consolidated	2Q2009e	2Q 2008	y/y	1H2009e	1H 2008	y/y
Total sales (PLN 000)	89,789	75,022	19.7%	163,364	165,751	-1.4%
Operating profit (PLN 000)	-5,043	-15,143	-66.7%	-11,521	23,706	-148.6%
Net income (PLN 000)	-14,313	-23,054	-37.9%	-34,050	-18,298	86.1%
Operating margin	-5.6%	-20.2%		-7.1%	14.3%	
Net margin	-15.9%	-30.7%		-20.8%	-11.0%	

Source: Erste Group Research

Following changes in the legislation, and contrary to earlier practice, Bioton will skip publishing its separate 2Q report and will announce directly its 1H09 results on August 31, 2009. We forecast the company posting a 2Q09 net loss of PLN 14.3mn on sales of PLN 89.8mn (consolidated and according to IFRS standards). With respect to the lackluster 1Q09 showing, with a net loss after minorities of PLN 19.7mn, we do not anticipate Bioton's bottom line leaving red territory. We envisage Bioton's net loss after minorities at PLN 34.0mn in 1H09, while sales are expected to retreat by 1.4% y/y to PLN 163.4mn. (The 1H08 top line was bolstered by PLN 24.5mn in one-off income related to the sale of rights to sell and distribute a vaccine in the Russia/CIS markets.) In the absence of a milestone payment related boost and further hampered by consolidating the Italian companies and MJ Bioton Life Sciences (with only meager profitability parameters), as well as restructuring costs (severance payments), Bioton's operating line is envisaged to sink into negative territory, to an operating loss of PLN 11.5mn in 1H09 (corresponding to a negative operating margin of 7.1% in 1H09, vs. a positive EBIT margin of

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14.3% in 1H08). Nevertheless, given the y/y more favorable forex developments, as well as 1Q09 proceeds from the HTL-Strefa disposal, the 1H09 financial result is expected to improve significantly y/y (in 1H08, it was hampered by the revaluation of its financial investment in HTL-Strefa of PLN 1.9mn and forex losses related to the weakening of the US dollar amounting to PLN 35mn). All told, we forecast the company posting a net loss of PLN 34.0mn in 1H09.

Valuation summary

12-month target price of PLN 0.31 indicates that, after its recent rise, Bioton's current price already factors in anticipated benefits from capital injection and hopes related to brightened business prospects

We stick to the parameters of our DCF model presented in our sector report from May 2009 (factoring in the risk-free rate of 6.0%) and the changed methodology for setting the equity risk premium (applying the equity risk premium for 2009-13 of 6.0% and of 5.7% for perpetuity). Incorporating all changes into our forecasts, we arrive at a 12-month target price of PLN 0.31 per share, slightly above the earlier target price of PLN 0.28 per share. While the 1Q09 results, with the operating and bottom lines in the red, would under normal circumstances put pressure on the stock price, Bioton's share price shrugged off the worries very quickly. The company's new strategy, presented to investors in May 2009, as well as the capital injection (promising to stabilize its financials and confirming the support from key shareholders to the new management team, headed by Janusz Guy), were the key factors behind this development. The announcements on the Bioton and Polpharma collaboration, as well as Bayer becoming Bioton's cooperation partner for sales and marketing of insulin in the Chinese market, were welcomed by investors, as the news reassured them that the company is finally starting to deliver on its promises. Although it remains to be seen if all of the ambitious targets can be achieved, there is no doubt that, under the new CEO, the company has finally taken steps in the right direction. The strengthened focus on the insulin niche and further product portfolio streamlining, including a thorough review of activities abroad and asset disposals, will be carefully watched by market participants.

Through the recently accomplished capital increase, Bioton acquired PLN 277.1mn (gross) in total. Furthermore, on July 1, 2009, Bioton announced that it will issue PLN 50mn in shares to its main shareholder Ryszard Krauze. In addition, the company secured up to USD 117mn (PLN 362.75mn) in financing from US investment fund GEM Global Yield Fund. The agreement guarantees Bioton financing at the level of a PLN 200mn equity credit line, from which Bioton can draw down tranches at its discretion over three years, starting with the signing of the deal, by requiring GEM to subscribe to ordinary shares at a 10% discount to the average closing price of Bioton's stock over a 21-day trading period before the drawdown. In addition, the company will also issue warrants to the investment fund worth PLN 162.75mn and exchangeable for its shares. (We want to emphasize that, for the sake of simplicity and due to the uncertain timing of possible financing from the GEM fund, neither the related proceeds nor the share capital increase are reflected in our current valuation model.)

We upgrade our recommendation from Reduce to Hold

With the news flow related to the restructuring gaining momentum, the positive sentiment towards the stock has been reset. While the materialization of some plans will still take time and we hence recommend that institutional investors take a rather cautious stance at the moment, with a new 12-month target price of PLN 0.31 per share, we upgrade our recommendation from Reduce to Hold. A further potential upgrade hinges (as before) on the company's ability to deliver more tangible results from its new strategy.

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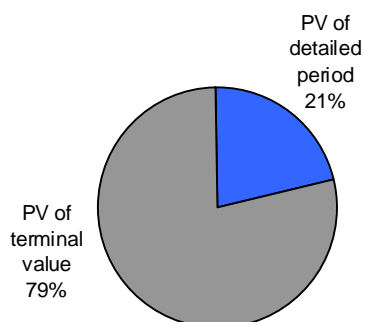
WACC calculation

	2009e	2010e	2011e	2012e	2013e	2014e (TV)
Risk free rate	6.0%	6.0%	6.0%	6.0%	6.0%	5.0%
Equity risk premium	6.0%	6.0%	6.0%	6.0%	6.0%	5.7%
Beta	0.8	0.8	0.8	0.8	0.8	1.0
Cost of equity	11.0%	11.0%	11.0%	11.0%	11.0%	10.7%
Cost of debt	7.5%	7.5%	7.5%	7.5%	7.5%	6.5%
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
After-tax cost of debt	6.1%	6.1%	6.1%	6.1%	6.1%	5.3%
Equity weight	89%	89%	89%	89%	89%	92%
WACC	10.5%	10.5%	10.5%	10.5%	10.5%	10.3%

DCF valuation

(PLN mn)	2009e	2010e	2011e	2012e	2013e	2014e (TV)
<i>Sales growth</i>	13.3%	62.6%	1.0%	25.9%	17.5%	7.0%
EBIT	-11.7	159.0	101.3	135.8	169.6	172.9
<i>EBIT margin</i>	-3.5%	29.4%	18.6%	19.8%	21.0%	20.0%
<i>Tax rate</i>	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Taxes on EBIT	2.2	-30.2	-19.3	-25.8	-32.2	-32.8
NOPLAT	-9.5	128.8	82.1	110.0	137.4	140.0
+ Depreciation	27.6	28.9	30.5	32.2	34.0	34.0
<i>Capital expenditures / Depreciation</i>	79.4%	90.5%	95.3%	99.0%	99.7%	100.0%
+/- Change in working capital	-1.5	-2.1	-2.7	-3.3	-3.8	-2.0
<i>Chg. working capital / chg. Sales</i>	-4.0%	-1.0%	-53.0%	-2.3%	-3.1%	-3.5%
- Capital expenditures	-22.0	-26.2	-29.0	-31.9	-33.9	-34.0
Free cash flow to the firm	-5.3	129.4	80.8	107.0	133.7	138.1
<i>Terminal value growth</i>						3.0%
Terminal value						1,958.7
<i>Discount factor</i>	0.90	0.82	0.74	0.67	0.61	0.55
Discounted free cash flow - Dec 31 2008	-4.8	106.0	59.8	71.8	81.1	1,153.8
Enterprise value - Dec 31 2008	1,467.7					
Minorities	131.1					
Non-operating assets	0.0					
Net debt	431.0					
Other adjustments	-327.1					
Equity value - Dec 31 2008	1,232.7					
Number of shares outstanding (mn)	4,695.4					
Cost of equity	11.0%					
12M target price per share (PLN)	0.31					
Current share price (PLN)	0.31					
<i>Up/Downside</i>	0.0%					

Enterprise value breakdown



Sensitivity (per share)

		Terminal value EBIT margin				
		19.0%	19.5%	20.0%	20.5%	21.0%
WACC	0					
	9.3%	0.34	0.35	0.36	0.36	0.37
	9.8%	0.32	0.32	0.33	0.34	0.35
	10.3%	0.30	0.30	0.31	0.32	0.32
	10.8%	0.28	0.28	0.29	0.30	0.30
11.3%	0.26	0.27	0.27	0.28	0.29	
		Terminal value growth				
		2.0%	2.5%	3.0%	3.5%	4.0%
WACC	0					
	9.3%	0.31	0.33	0.36	0.39	0.42
	9.8%	0.29	0.31	0.33	0.36	0.39
	10.3%	0.27	0.29	0.31	0.33	0.36
	10.8%	0.26	0.27	0.29	0.31	0.33
11.3%	0.25	0.26	0.27	0.29	0.31	

Source: Erste Group Research, other adjustments include cash proceeds from capital increases (PLN 277.1mn +PLN 50mn)

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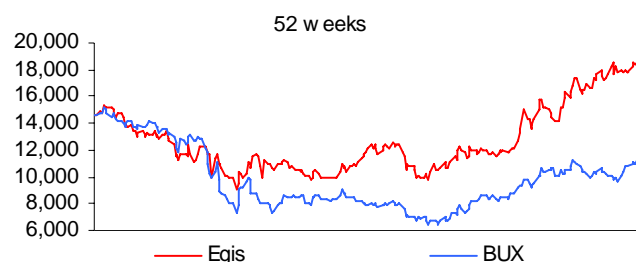
Income Statement	2006	2007	2008	2009e	2010e	2011e
(IAS, PLN mn, 31/12)	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2011
Net sales	215.48	270.94	293.52	332.55	540.89	546.07
Cost of goods sold	-81.64	-122.93	-164.37	-201.27	-203.43	-237.23
Gross profit	133.84	148.01	129.15	131.28	337.46	308.84
SG&A	-85.47	-110.19	-127.86	-129.70	-159.56	-200.68
Other operating revenues	47.16	82.39	15.10	14.96	16.23	17.75
Other operating expenses	-20.67	-12.13	-87.88	-28.27	-35.16	-24.57
EBITDA	88.54	128.81	-47.75	15.93	187.91	131.80
Depreciation/amortization	-13.68	-20.72	-23.73	-27.64	-28.95	-30.47
EBIT	74.86	108.09	-71.49	-11.71	158.96	101.33
Financial result	32.03	-93.19	-196.52	-43.79	-27.29	-18.13
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	106.88	14.90	-268.00	-55.50	131.68	83.20
Income taxes	-14.19	11.59	44.97	10.54	-25.02	-15.81
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	1.07	1.65	4.14	2.07	1.97	-1.87
Net result after minorities	93.77	28.13	-218.89	-42.88	108.63	65.52
Balance Sheet	2006	2007	2008	2009e	2010e	2011e
(IAS, PLN mn, 31/12)						
Intangible assets	395.91	666.27	1,023.53	968.96	968.01	967.05
Tangible assets	169.23	268.62	488.85	399.31	400.61	403.27
Financial assets	65.01	170.16	181.92	196.26	212.43	230.80
Total fixed assets	630.14	1,105.05	1,694.30	1,564.54	1,581.05	1,601.12
Inventories	61.99	99.63	92.97	92.17	97.44	98.38
Receivables and other current assets	229.77	248.49	215.78	228.30	237.80	256.66
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	66.76	47.08	61.72	167.07	151.36	203.71
Total current assets	358.53	395.20	370.47	487.54	486.60	558.75
TOTAL ASSETS	988.67	1,500.26	2,064.77	2,052.08	2,067.65	2,159.87
Shareholders'equity	787.61	871.11	1,106.55	1,334.26	1,369.02	1,459.58
Minorities	17.53	14.44	131.14	66.03	66.03	66.03
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
Other LT provisions	0.00	0.00	0.00	0.00	0.00	0.00
Interest-bearing LT debts	7.62	163.87	163.90	163.90	57.36	56.79
Other LT liabilities	60.58	52.22	72.74	76.37	80.19	84.20
Total long-term liabilities	68.20	216.08	236.63	240.27	137.56	140.99
Interest-bearing ST debts	54.33	246.06	328.81	115.08	109.33	103.86
Other ST liabilities	61.00	152.57	261.64	296.44	385.72	389.41
Total short-term liabilities	115.33	398.63	590.45	411.52	495.05	493.27
TOTAL LIAB. , EQUITY	988.67	1,500.25	2,064.77	2,052.08	2,067.65	2,159.87
Cash Flow Statement	2006	2007	2008	2009e	2010e	2011e
(IAS, PLN mn, 31/12)						
Cash flow from operating activities	-7.92	-0.58	37.75	13.92	122.77	87.43
Cash flow from investing activities	-392.27	-320.52	-289.40	-21.96	-26.20	-29.04
Cash flow from financing activities	454.67	301.42	266.29	113.39	-112.29	-6.04
CHANGE IN CASH , CASH EQU.	54.48	-19.68	14.64	105.35	-15.71	52.36
Margins & Ratios	2006	2007	2008	2009e	2010e	2011e
Sales growth	42.1%	25.7%	8.3%	13.3%	62.6%	1.0%
EBITDA margin	41.1%	47.5%	-16.3%	4.8%	34.7%	24.1%
EBIT margin	34.7%	39.9%	-24.4%	-3.5%	29.4%	18.6%
Net profit margin	43.0%	9.8%	-76.0%	-13.5%	19.7%	12.3%
ROE	18.0%	3.4%	-22.1%	-3.5%	8.0%	4.6%
ROCE	15.5%	3.1%	-13.9%	-1.9%	7.2%	4.5%
Equity ratio	81.4%	59.0%	59.9%	68.2%	69.4%	70.6%
Net debt	-4.8	362.8	431.0	111.9	15.3	-43.1
Working capital	243.2	-3.4	-220.0	76.0	-8.4	65.5
Capital employed	860.9	1,300.6	1,741.4	1,588.6	1,530.6	1,566.7
Inventory turnover	1.6	1.5	1.7	2.2	2.1	2.4

Source: Company data, Erste Group estimates

Egis from Buy to Accumulate

Vladimira Urbankova, MBA +43 50100 17343 vladimira.urbankova@erstegroup.com

HUF mn	2008	2009e	2010e	2011e
Net sales	96,008.0	109,785.2	113,061.2	119,753.8
EBITDA	16,018.0	22,140.3	23,206.2	26,290.9
EBIT	8,474.0	13,988.9	14,652.1	17,160.5
Net result after min.	13,959.0	14,783.3	15,032.5	17,363.1
EPS (HUF)	1,792.90	1,898.77	1,930.78	2,230.13
CEPS (HUF)	2,740.15	2,942.80	3,026.57	3,400.00
BVPS (HUF)	14,823.78	16,602.55	18,413.33	20,523.45
Div./share (HUF)	120.00	120.00	120.00	120.00
EV/EBITDA (x)	4.6	5.4	4.8	3.8
P/E (x)	6.3	9.7	9.6	8.3
P/CE (x)	4.1	6.3	6.1	5.4
Dividend Yield	1.1%	0.7%	0.7%	0.7%



Performance	12M	6M	3M	1M
in HUF	26.3%	51.7%	53.8%	6.1%
in EUR	9.7%	64.1%	69.9%	10.2%

Share price (HUF)	18460.00	Reuters	EGIS.BU	Free float	49.1%
Number of shares (mn)	7.8	Bloomberg	EGIS HB	Shareholders	Servier (50.9%)
Market capitalization (HUF mn / EUR mn)	143,724 / 537	Div. Ex-date	18/05/09		
Enterprise value (HUF mn / EUR mn)	119,815 / 448	Target price	21,785.0	Homepage:	www.egis.hu

Despite rally, multiples still attractive

- Our revised DCF-derived 12-month target price is HUF 21,785 per share, above our earlier target of HUF 19,955. Although, after this year's rally, Egis' stock is not immune to profit taking, we believe that the very sound prospects, including improving home market fortunes, are not yet fully priced in. While the company's lower than average profitability parameters call for keeping a certain discount to its peers, the current valuation gap remains wide and Egis' valuation multiples are attractive. Nevertheless, as the stock has approached our target price (after the strong appreciation), we downgrade our recommendation from Buy to Accumulate.
- We have incorporated into our model 1) the upbeat outlook for domestic sales, which, fueled by new product launches, are envisaged to rise by 8% y/y in 2010; 2) the R&D investment linked deductions from payment obligations to OEP, bolstering EBIT in the coming years; 3) the revised HUF/USD average exchange rates for 2009 and the coming years, with the stronger than earlier envisaged HUF. All told, we slightly decrease our 2008/09 net profit target to HUF 14,783mn. Reflecting the more robust domestic sales and bolstering impact of lower payments to OEP, but less favorable currency fortunes, our new net profit target for 2009/10 is down 4.6% compared to our previous forecast.
- Egis' 3Q2008/09 results are expected to confirm the stabilizing home market performance. While Russian exports should feel the supportive effect of the ruble appreciation (reducing the forex linked discounts to partners), given the high comparative base, we anticipate them retreating y/y in 3Q. In total, we forecast the company posting 3Q sales of HUF 26,952mn, up 17.2% y/y. The y/y shrinking share of bulk chemicals and low comparative base still bode well for improvement in the company's gross and operating margins. We project EBIT jumping 83.7% y/y to HUF 3,757mn. With the financial result hit by the unfavorable closing exchange rate at the end of 3Q, we expect net profit down 12.4% y/y to HUF 1,954mn in 3Q.

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Changes in forecast / outlook

Domestic market plans ambitious, with accelerating tempo driven by new product launches

In 1H08/09, Egis' domestic sales were practically flat at HUF 14,661mn, whereas second quarter sales soared by 10% y/y, helped by the low comparative base. In a q/q comparison, they were flat (up by just 0.4%), confirming that pricing pressures are easing over time. The recent regulatory measures, particularly the reduction of reimbursement rates (increasing patients' co-payments; introduced from April 2009), represent a downside risk. However, reflecting the lower price erosion, CFO Laszlo Marosffy has been sticking to the earlier guidance, envisaging for FY08/09 domestic sales growth of around 2% y/y. Consequently, we leave our 2008/09 domestic sales growth target unchanged at 2.0% y/y to around HUF 29.9bn. Not only is the home market situation seen as gradually stabilizing, but the company's efforts to rejuvenate its product portfolio are gathering pace. As a result, the company recently upped its 2009/10 home sales guidance again, from the (May 2009) revised target of a 5.0% y/y rise to 8.0% growth. Consequently, we are prompted to make an adequate adjustment to our projections and lift our 2009/10 projected domestic sales target from some HUF 30.8bn (corresponding to a 3.0% y/y rise) to HUF 32.3bn (translating into an 8% y/y tempo). Importantly, the company aims (via new product introductions) to keep such a relatively high tempo, of 6% to 8% y/y, in the medium term.

Weaker forint y/y to bolster export sales

Russia/CIS: In 1H08/09, sales within the DLO program reached USD 5.3mn, out of the USD 62.4mn period total, providing further evidence of the key importance of the private market for Egis' sales performance in Russia. It was encouraging to see that Egis' sales growth in Russia stayed in double-digit terms (with sales up 14.8% y/y) in the challenging 2Q08/09. The company's agreement with wholesale partners on sharing risks of ruble depreciation was (apart from the year-earlier low comparative base) undoubtedly bolstering the result. Nevertheless, going forward, CFO Marosffy became more cautious and revised his guidance to a 5-10% y/y tempo (from the earlier anticipated 10% y/y) in Russia for 2008/09. The main cause for worry remains Ukraine, where Egis' sales - due to the sharply depreciating hryvnia - temporarily nearly halted and only minor improvements have been seen so far. (In 1H08/09, Egis' sales in Ukraine slumped by 30% y/y.) Hence, it was no surprise that the company further revised its Russia/CIS targets downwards, from 8% to around a 3% to 5% y/y rise for 2008/09. With the Ukrainian market showing the first promising signs of a recovery recently, we revise our earlier (more pessimistic) forecasts for Russia/CIS sales slightly upwards, from USD 160.2mn to USD 165.0mn for 2008/09, corresponding to a 3% y/y rise vs. the earlier envisaged flat sales. At the same time, we increase our target for Russian sales in 2008/09 as well, from a 6% to a 7% y/y rise in USD terms. Acceleration is still projected for 2009/10 and we forecast an 8% y/y rise both in Russia and the Russia/CIS region as a whole (all in USD terms), broadly corresponding to the company's newly revealed guidance.

CEE markets: After a very strong showing, with a boost coming from pre-shipments to Poland, the second quarter has brought a cooling (as anticipated), due not least to the weakening of regional currencies, hitting in particular sales in Poland and Romania. Consequently, the company reduced its guidance from a 12% y/y rise to 5%. As this corresponds to our targeted growth, we leave our forecast for Central and Eastern European markets for 2008/09 unchanged at USD 146.6mn. As before, with regional currencies set for stabilization and appreciation in the medium term, we continue to envisage Egis' sales tempo in the CEE region staying at a relatively high (i.e. around 10% to 12% y/y) level in the medium term (the next three years).

Western markets: As further evidenced by 2Q08/09 results (sales up by 15% y/y), despite the already relatively high comparative base, sales of finished products are poised to pick up this year. Further supported by the latest company guidance, we raise our forecast and envisage 2008/09 sales growth in this category of around 18% y/y to USD 32mn. The 1H08/09 performance confirmed that sales of bulk chemicals (fueled by API supplies for Servier) are set to lose steam in 2008/09, after their peak in 2007/08 (which was based on stock buildup and high initial deliveries for Servier product launches). Based on the slightly weaker than earlier estimated order flow from both Servier and other partners, we reduce our earlier forecast and assume a 40% (vs. the earlier projected 30%) y/y fall (to around USD 46mn) in 2008/09 in this category. We also slash our 2009/10 target to some USD 36mn.

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Finally, we factor in a newly revised currency forecast (annual average exchange rate of HUF 199.1/USD for 2009, from HUF 202.0/USD, and annual average exchange rate of HUF 186.2/USD for 2010, from HUF 189.7/USD). After incorporating all of the above-mentioned changes into our sales projections, our 2008/09 sales target is fine-tuned to around HUF 109.8bn, vs. the previous forecast of HUF 110.3bn. For 2009/10, our new sales target arrives at HUF 113.1bn, vs. the previous forecast of HUF 114.0bn.

Summary of changes to 2008/09 and 2009/10 forecasts

(HUF 'mn)	08/09 orig.forecast		08/09 new forecast		09/10 orig.forecast		09/10 new forecast	
Net sales	110,262	100.0%	109,785	100.0%	114,036	100.0%	113,061	100.0%
Cost of sales	44,219	40.1%	43,956	40.0%	45,503	39.9%	45,155	39.9%
Gross profit	66,044	59.9%	65,829	60.0%	68,532	60.1%	67,906	60.1%
Marketing & distr.costs	25,857	23.5%	25,736	23.4%	26,755	23.5%	26,835	23.7%
Administration costs	13,224	12.0%	13,166	12.0%	13,608	11.9%	13,498	11.9%
R & D costs	9,829	8.9%	9,787	8.9%	10,090	8.8%	10,094	8.9%
Other operating exp.	3,986	3.6%	3,986	3.6%	4,125	3.6%	3,675	3.3%
Other oper. income	835	0.8%	835	0.8%	848	0.7%	848	0.8%
Operating profit	13,983	12.7%	13,989	12.7%	14,803	13.0%	14,652	13.0%
Financial result	3,019	2.7%	2,164	2.0%	2,474	2.2%	1,788	1.6%
Pre-tax profit	17,002	15.4%	16,153	14.7%	17,277	15.2%	16,440	14.5%
Income taxes	1,480	1.3%	1,370	1.2%	1,516	1.3%	1,407	1.2%
Net Income	15,522	14.1%	14,783	13.5%	15,761	13.8%	15,032	13.3%

Source: Erste Group Research

Favorable changes in sales mix, currency situation to shore up gross margin

The positive changes in the product mix (in particular, the sizable reduction in the proportion of bulk chemicals), along with the y/y more favorable forex situation, continue to work in Egis' favor this year and help the company to counterbalance the negative impact of the home market price erosion and decreasing share of high-margin Russia/CIS sales in 2008/09 on profitability margins. Egis' gross margin reached 60.3% in 1H08/09. We remain on the conservative side and assume that, in the coming periods, the pace of improvements will be tempered (due in part to the fact that the company will be running out of the inventories created in the period of the strong forint); a gross margin close to the 60% mark should be achievable for the full fiscal year 2008/09. We opt to slightly increase our target for the gross margin to 60.0% (up from the earlier estimate of 59.9% and the 2007/08 fiscal year figure of 56.8%). Going forward, despite the adverse currency trend, we believe that – helped by the more favorable sales mix - our gross margin target for FY09/10 of 60.1% is still realistic.

Bolstered by currency fortunes, EBIT margin poised for recovery in 2008/09

The 1H08/09 results demonstrated that management's cost control, augmented by favorable external conditions and one-off factors, brought a desirable turn in the earlier ailing operating profitability. In the absence of the pre-shipments' boost to the top line (without associated operating costs), the operating margin retreated from the 19.5% recorded in 1Q to 10.5% in the second quarter (up from 9.4% in the year-earlier period), bringing the 1H08/09 EBIT margin to 15.1%, up from 10.0% in 1H07/08. Sales and marketing expenses rose by 10.0% y/y in 1H08/08 and their share in total sales slipped to 21.5%. We opt to remain on the conservative side and make only a small cut in our projections, decreasing their share from 23.5% to 23.4% of total sales in 2008/09. With fees for sales representatives reintroduced from mid-February 2009 (hence to be accounted for three quarters of 2008/09 - the same as in the past fiscal year) and domestic sales rising only marginally, payments to the National Health Insurance Fund (OEP) are expected to remain practically unchanged y/y at around HUF 2bn in 2008/09. (Here it is important to stress that, similarly to its home peer Richter, Egis will be able – based on its R&D spending – to skip the obligatory payments to OEP (12% rebate on sales of reimbursed drugs and med rep fees) in future. According to estimates from CFO Marosffy, the positive impact from these legislative changes on Egis' operating profit will be savings of HUF 450mn in the first year and more than HUF 2.0bn in the forthcoming years.

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While the positive impact from the y/y forint weakening is set to be less profound in the coming periods, we believe that the company has all prerequisites to stabilize its EBIT margin above the 10% mark. All things considered, we stick to our operating margin target of 12.7% for 2008/09. Although the currency's positive effect will diminish in 2009/10, the favorable changes in the territorial and product mix, as well as prudent cost control, promise another (albeit less steep) improvement in operating profitability. All told, we stick to our forecast for 2009/10 and project the EBIT margin at 13.0%. The financial result in the second quarter of 2008/08 enjoyed a nice boost from the impact of the end-period forint weakness on the reassessment of the receivables/payables balance (reflected in the forex result). While the financial result surpassed our expectations in 1H08/09, with the swing in currency fortunes in the cards, and 3Q wiping out the previous quarter's gains, we opt for a minor downward adjustment to our full fiscal year 2008/09 financial result target (from around HUF 3.0bn to HUF 2.2bn). All told, our new net profit target arrives at HUF 14,783mn for 2008/09 (vs. the earlier forecast of HUF 15,522mn) and HUF 15,032mn for 2009/10 (down from the previous target of HUF 15,761mn).

3Q08/09 results preview

Egis is scheduled to announce its 1-3Q08/09 report on August 5, 2009, after market close. We expect net profit of HUF 12,714mn on sales of HUF 82,336mn for October 2008-June 2009, the first three quarters of Egis' 2008/09 fiscal year. In 3Q08/09 alone, we forecast Egis' net profit at HUF 1,954mn, on sales of HUF 26,952mn.

Unconsolidated sales preview	3Q 08/09e	3Q 07/08	y/y	1-3Q 08/09e	1-3Q 07/08	y/y
Hungary (HUF mn)	7,589	7,227	5.0%	22,250	21,898	1.6%
Russia (USD mn)	27.4	31.3	-12.3%	89.8	81.9	9.7%
CIS (USD mn)	13.4	12.9	4.2%	31.8	34.8	-8.6%
Eastern Europe (USD mn)	30.7	32.6	-5.8%	99.8	96.9	3.0%
Other (USD mn)	20.6	23.0	-10.4%	62.9	83.1	-24.3%
Total export (USD mn)	92.1	99.7	-7.6%	284.4	296.6	-4.1%
IFRS unconsolidated	3Q 08/09e	3Q 07/08	y/y	1-3Q 08/09e	1-3Q 07/08	y/y
Net sales (HUF mn)	26,952	23,000	17.2%	82,336	71,733	14.8%
Operating profit (HUF mn)	3,757	2,045	83.7%	12,133	6,910	75.6%
Net income (HUF mn)	1,954	2,231	-12.4%	12,714	8,076	57.4%
Operating margin	13.9%	8.9%		14.7%	9.6%	
Net margin	7.3%	9.7%		15.4%	11.3%	

Source: Erste Group Research

Reflecting the relatively low comparative base and gradually slowing price erosion, we envisage Egis' domestic sales advancing by some 5.0% y/y to HUF 7.6bn in 3Q08/09, sending the 1-3Q08/09 domestic sales to HUF 22.25bn, up 1.6% y/y. Despite the q/q forint firming, the y/y forex picture still points to a solid currency cushion, to be enjoyed by exports in HUF terms, helping the company to sustain a double-digit top line tempo in 3Q08/09. Reflecting the more favorable currency developments in April – June 2009, with the steep fall of CEE currencies halted, as well as leveling off the pre-shipment effect, Egis' Eastern European sales are expected to rise 42.6% q/q (but still fall by 5.8% y/y) to USD 30.7mn in 3Q08/09, bringing 1-3Q08/09 sales in Eastern Europe to USD 99.8mn, up 3.0% y/y. With the somewhat easing effect of the economic difficulties in Ukraine and other CIS markets (and pick-up in the earlier replenished inventory levels), we anticipate Egis' exports to CIS rising both q/q and y/y in 3Q08/09. While Egis' performance in Russia is anticipated to be sound, with respect to the relatively high comparative base, we forecast Egis' Russian sales retreating (by 12.3% y/y) to USD 27.4mn in 3Q08/09. Nevertheless, with respect to the previous strong showing, this translates into a y/y rise for Egis' Russia and Russia/CIS sales in the first nine months of 2008/09 (by 9.7% and 4.2%, respectively). Finally, similarly to the previous quarter, sales to Western markets are expected to be dragged down by the y/y lower deliveries of APIs to Servier. In total, we forecast Egis' sales to Western markets at around USD 20.6mn in 3Q08/09, down 10.4% y/y, out of which bulk chemicals are expected to contribute USD 9mn. In summary, we envisage Egis' sales growing by a sound 14.8% y/y to HUF 82,336mn in 1-3Q08/09.

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The y/y improving sales mix (in particular, the slump in the proportion of bulk chemicals in total sales), augmented by the still more favorable currency situation, should bolster Egis' profitability margins in 3Q08/09. We forecast 3Q08/09 operating profit up 83.7% y/y to HUF 3,757mn, translating into an EBIT margin of 13.9% (up from 8.9% in the previous-year period, but somewhat below the 1H08/09 EBIT margin of 15.1%, which was boosted by the positive impact of pre-shipments and strong currency effects). Consequently, this translates into our 1-3Q08/09 EBIT forecast of HUF 12,133mn (and EBIT margin target of 14.7%). While the end-quarter foreign exchange rate situation was far less favorable than at the end of 2Q08/09, largely erasing the previous period's gains, the company's financial result should stay firmly in the black in 1-3Q at around HUF 1,340mn. All told, we expect the company's 1-3Q08/09 net profit to surge 57.4% y/y to HUF 12,714mn, out of which the third quarter is expected to deliver HUF 1,954mn.

Valuation summary

We adjust our DCF model parameters to include decreasing bond yields

While the pains from the financial market crisis are gradually easing, compared to other core CEE countries, the economic situation in Hungary continues to be somewhat more challenging, adding pressure on Hungarian stocks' valuations, as it is keeping bond yields (and the required premiums) above their CEE-based counterparts'. Reflecting the decrease in government bond yields as of lately, we reduce the risk-free rate from 9.0% to 8.5% for the detailed forecast period of 2009-14. Applying the equity risk premium of 6.75% to the market premium for the forecast period and 6.3% for perpetuity yields WACC of 14.2% for 2009-14 and 11.3% for perpetuity. 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 amounts to HUF 21,785 per share, above our earlier target price of HUF 19,955.

While we raise our 12-month target price to HUF 21,785 per share, we downgrade recommendation from Buy to Accumulate

Although some risks remain, we believe that the currency assumptions in our model are conservative and that the bias is (as before) rather on the upward side, with the anticipated gradual decrease in risk associated premiums promising to give an additional lift to the company's target price. We also want to reiterate that, similarly to its home peer Richter, Egis' balance sheet is very sound, with practically no external debt. The company has a solid cash pile (of nearly HUF 20bn at the end of March 2009). Apart from financing the modernization of its API facilities, including improving their efficiency, Egis does not rule out possible acquisitions, eyeing smaller generic company targets in CEE, Russia/CIS, Southeast Europe, and eventually even outside the EU (the latter envisaged to offer - in addition to desirable synergy effects - also exploitation of differences in patent situations). While it is still too early to speculate about the possible outcome of these efforts, the recent market entry into Turkey shows that the company does not neglect opportunities in quickly growing emerging markets. We believe that the company's healthy financial shape and high degree of transparency speak in favor of investment in the stock in the currently turbulent market environment. Finally, while the company's below-average profitability parameters justify a certain discount to its peers, the valuation gap (despite the stock's rally this year) remains wide. Nevertheless, with the stock appreciating by 51.7% since we published our sector report in May 2009, we cut our recommendation from Buy to Accumulate.

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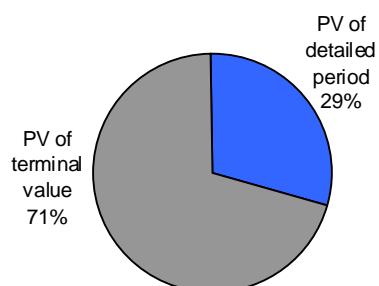
WACC calculation

	2010e	2011e	2012e	2013e	2014e	2015e (TV)
Risk free rate	8.5%	8.5%	8.5%	8.5%	8.5%	5.0%
Equity risk premium	6.75%	6.75%	6.75%	6.75%	6.75%	6.3%
Beta	0.8	0.8	0.8	0.8	0.8	1.0
Cost of equity	14.2%	14.2%	14.2%	14.2%	14.2%	11.3%
Cost of debt	10.0%	10.0%	10.0%	10.0%	10.0%	6.5%
Effective tax rate	10.0%	10.0%	10.0%	10.0%	10.0%	19.0%
After-tax cost of debt	9.0%	9.0%	9.0%	9.0%	9.0%	5.3%
Equity weight	100%	100%	100%	100%	100%	100%
WACC	14.2%	14.2%	14.2%	14.2%	14.2%	11.3%

DCF valuation

(HUF mn)	2010e	2011e	2012e	2013e	2014e	2015e (TV)
<i>Sales growth</i>	3.0%	5.9%	7.9%	8.2%	8.2%	6.0%
EBIT	14,652.1	17,160.5	18,495.3	20,070.1	21,855.0	22,438.3
<i>EBIT margin</i>	13.0%	14.3%	14.3%	14.4%	14.5%	14.0%
<i>Tax rate</i>	10.0%	10.0%	10.0%	10.0%	10.0%	19.0%
Taxes on EBIT	-1,465.2	-1,716.0	-1,849.5	-2,007.0	-2,185.5	-4,263.3
NOPLAT	13,186.9	15,444.4	16,645.7	18,063.1	19,669.5	18,175.0
+ Depreciation	8,554.1	9,130.4	9,789.3	10,521.3	11,346.5	11,346.5
<i>Capital expenditures / Depreciation</i>	121.4%	122.6%	122.9%	121.4%	119.8%	100.0%
+/- Change in working capital	-1,494.7	-2,350.7	-3,511.8	-4,307.0	-4,959.0	-3,628.8
<i>Chg. working capital / chg. Sales</i>	-45.6%	-35.1%	-37.1%	-40.9%	-43.3%	-40.0%
- Capital expenditures	-10,387.6	-11,190.3	-12,030.3	-12,767.6	-13,588.1	-11,346.5
Free cash flow to the firm	9,858.7	11,033.8	10,892.9	11,509.8	12,468.8	14,546.2
<i>Terminal value growth</i>						3.0%
Terminal value						180,512.9
Discounted free cash flow - September 30 2009	8,635.1	8,464.9	7,319.6	6,774.2	6,427.9	90,346.5
Enterprise value - September 30 2009	127,968.1					
Minorities	0.0					
Non-operating assets	0.0					
Net debt	-23,909.0					
Other adjustments	0.0					
Equity value - September 30 2009	151,877.1					
Number of shares outstanding (mn)	7.8					
Cost of equity	14.2%					
12M target price per share (HUF)	21785					
Current share price (HUF)	18,460					
<i>Up/Downside</i>	18.0%					

Enterprise value breakdown



Sensitivity (per share)

		Terminal value EBIT margin					
		21785	13.0%	13.5%	14.0%	14.5%	15.0%
WACC	10.3%	22,245	22,903	23,560	24,218	24,875	
	10.8%	21,385	22,000	22,616	23,231	23,846	
	11.3%	20,628	21,207	21,785	22,363	22,941	
	11.8%	19,958	20,503	21,049	21,594	22,139	
	12.3%	19,359	19,875	20,391	20,907	21,424	
		Terminal value growth					
		21785	2.0%	2.5%	3.0%	3.5%	4.0%
WACC	10.3%	21,785	22,616	23,560	24,643	25,899	
	10.8%	21,049	21,785	22,616	23,560	24,643	
	11.3%	20,391	21,049	21,785	22,616	23,560	
	11.8%	19,801	20,391	21,049	21,785	22,616	
	12.3%	19,269	19,801	20,391	21,049	21,785	

Source: Erste Group Research

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Income Statement	2006	2007	2008	2009e	2010e	2011e
(IAS, HUF mn, 30/09)	30/09/2006	30/09/2007	30/09/2008	30/09/2009	30/09/2010	30/09/2011
Net sales	87,361.52	92,489.00	96,008.00	109,785.16	113,061.20	119,753.84
Cost of goods sold	-31,497.58	-41,121.00	-41,512.00	-43,956.27	-45,154.78	-47,803.80
Gross profit	55,863.94	51,368.00	54,496.00	65,828.89	67,906.42	71,950.05
SG&A	-31,899.32	-32,919.00	-34,252.00	-38,902.33	-40,333.47	-42,905.76
Other operating revenues	163.76	623.00	944.00	835.44	847.97	848.82
Other operating expenses	-8,649.00	-11,009.00	-12,714.00	-13,773.08	-13,768.82	-12,732.63
EBITDA	20,944.37	14,265.00	16,018.00	22,140.28	23,206.18	26,290.91
Depreciation/amortization	-5,465.00	-6,202.00	-7,544.00	-8,151.36	-8,554.08	-9,130.44
EBIT	15,479.37	8,063.00	8,474.00	13,988.92	14,652.10	17,160.47
Financial result	2,240.38	-155.00	6,012.00	2,164.28	1,787.52	1,958.06
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	17,719.76	7,908.00	14,486.00	16,153.20	16,439.63	19,118.53
Income taxes	-2,194.72	-244.00	-527.00	-1,369.92	-1,407.15	-1,755.41
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	15,525.04	7,664.00	13,959.00	14,783.29	15,032.48	17,363.12
Balance Sheet	2006	2007	2008	2009e	2010e	2011e
(IAS, HUF mn, 30/09)						
Intangible assets	549.03	600.00	3,785.00	2,985.00	2,335.00	1,835.00
Tangible assets	38,838.68	42,582.00	46,793.00	51,178.14	55,692.16	60,583.61
Financial assets	8,693.55	10,140.00	7,661.00	8,235.58	8,853.24	9,517.24
Total fixed assets	48,081.26	53,322.00	58,239.00	62,398.71	66,880.40	71,935.85
Inventories	28,373.09	28,604.00	32,430.00	34,302.43	35,326.03	36,855.89
Receivables and other current assets	20,588.25	22,443.00	25,213.96	25,935.75	26,709.69	28,149.31
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	9,606.68	10,778.00	14,447.04	23,909.01	32,891.19	42,951.09
Total current assets	58,568.02	61,825.00	72,091.00	84,147.20	94,926.91	107,956.29
TOTAL ASSETS	106,649.28	115,147.00	130,330.00	146,545.91	161,807.31	179,892.14
Shareholders'equity	95,658.87	102,388.72	115,413.72	129,262.71	143,360.90	159,789.74
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
Other LT provisions	1,307.68	1,692.00	1,523.00	1,500.16	1,477.65	1,455.49
Interest-bearing LT debts	0.00	0.00	0.00	0.00	0.00	0.00
Other LT liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Total long-term liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Interest-bearing ST debts	0.00	0.00	0.00	0.00	0.00	0.00
Other ST liabilities	9,682.73	11,066.29	13,393.29	15,783.04	16,968.76	18,646.91
Total short-term liabilities	7,309.23	9,226.00	10,903.00	12,217.25	12,561.47	13,222.39
TOTAL LIAB. , EQUITY	106,649.28	115,147.00	130,330.00	146,545.91	161,807.31	179,892.14
Cash Flow Statement	2006	2007	2008	2009e	2010e	2011e
(IAS,HUF mn, 30/09)						
Cash flow from operating activities	12,307.77	13,694.00	6,076.00	17,030.89	20,304.36	22,184.76
Cash flow from investing activities	-9,028.13	-10,144.00	-8,398.00	-9,053.29	-10,387.60	-11,190.28
Cash flow from financing activities	-2,868.89	-934.29	-934.29	-934.59	-934.59	-934.59
CHANGE IN CASH , CASH EQU.	410.75	2,615.71	-3,256.29	7,043.01	8,982.18	10,059.89
Margins & Ratios	2006	2007	2008	2009e	2010e	2011e
Sales growth	20.3%	5.9%	3.8%	14.4%	3.0%	5.9%
EBITDA margin	24.0%	15.4%	16.7%	20.2%	20.5%	22.0%
EBIT margin	17.7%	8.7%	8.8%	12.7%	13.0%	14.3%
Net profit margin	17.8%	8.3%	14.5%	13.5%	13.3%	14.5%
ROE	17.6%	7.7%	12.8%	12.1%	11.0%	11.5%
ROCE	18.4%	7.9%	13.3%	12.8%	12.5%	13.8%
Equity ratio	89.7%	88.9%	88.6%	88.2%	88.6%	88.8%
Net debt	-9,606.7	-10,778.0	-14,447.0	-23,909.0	-32,891.2	-42,951.1
Working capital	51,258.8	52,599.0	61,188.0	71,930.0	82,365.4	94,733.9
Capital employed	87,359.9	93,302.7	102,489.7	106,853.9	111,947.4	118,294.1
Inventory turnover	1.2	1.4	1.4	1.3	1.3	1.3

Source: Company data, Erste Group estimates

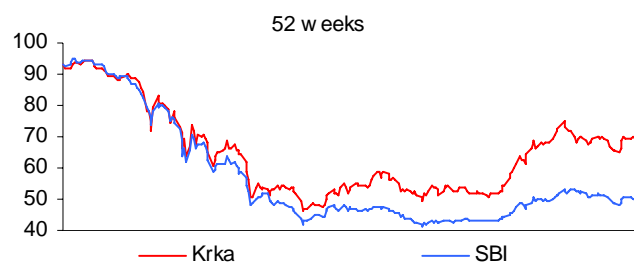
Sector Report – Erste Sector Healthcare

Company Report – Pharmaceuticals – Slovenia – July 28, 2009

Krka Buy

Vladimira Urbankova, MBA +43 50100 17343 vladimira.urbankova@erstegroup.com

EUR mn	2008	2009e	2010e	2011e
Net sales	949.9	1,043.5	1,166.6	1,310.4
E BITDA	308.4	325.0	364.7	407.9
EBIT	236.8	245.1	275.7	310.0
Net result after min.	156.0	164.0	196.3	225.9
EPS (EUR)	4.40	4.63	5.54	6.38
CEPS (EUR)	6.59	6.82	7.85	8.94
BVPS (EUR)	22.06	25.78	30.27	35.55
Div./share (EUR)	1.05	1.10	1.20	1.40
E V/EBITDA (x)	6.2	8.2	7.3	6.5
P/E (x)	11.0	15.1	12.6	11.0
P/CE (x)	7.3	10.3	8.9	7.8
Dividend Yield	2.2%	1.6%	1.7%	2.0%



Performance in EUR	12M	6M	3M	1M
	-25.1%	29.9%	34.8%	2.8%

Share price (EUR)	69.92	Reuters	KRKG.LJ	Free float	70.2%
Number of shares (mn)	35.4	Bloomberg	KRKG SV	Shareholders	SOD Fund (15.0%)
Market capitalization (EUR mn)	2,477.0	Div. Ex-date	06/07/09		KAD & PPS (10.2%)
Enterprise value (EUR mn)	2,670.4	Target price	106.5	Homepage:	www.krka.si

Superior profitability, possible boost from release of provision not priced in

- Our revised DCF-derived 12-month target price arrives at EUR 106.5 per share. While this is only slightly changed from the earlier value of EUR 105.0 per share, we want to emphasize that, in the case of a final end to the atorvastatin litigation (with EUR 69.3mn added to 2009 earnings), the target price would increase to around EUR 108 per share. Although Krka keeps its position as the most liquid Ljubljana-listed stock, its traditional premium to its CEE-based rivals has evaporated, along with the diminishing appeal of its home stock exchange for increasingly (liquidity-) risk-averse investors. We believe that Krka's regional competitive edge and healthy business performance (and outlook), firmly based on its R&D pipeline full of innovative generics, remain key arguments for the stock price appreciation and its return to investors' favor. All told, we stick to our Buy recommendation.
- The changes to our model focus on reflecting 1) the recently reported preliminary sales highlights for 1H2009, with the regional currencies' depreciation vs. the euro, as well as the economic slowdown dampening the export tempo namely in Southeast Europe and CIS markets; and 2) the significantly better gross and operating margin, but also the weaker than expected financial result posted in 1Q09. Reflecting the negative impact stemming from the regional currencies' weakening vs. Krka's reporting and main operating currency, the euro, but still assuming a pickup of Western European sales in 2H09 (driven by new product launches), we adjust our 2009 top line projections to EUR 1,043.5mn. With respect to the impressive 1Q showing, we raise our gross and EBIT margin assumptions. We forecast Krka's operating profit at EUR 245.1mn (up 3.5% y/y) in 2009. Nevertheless, incorporating into the financial results a worse than expected forex burden, we leave our net profit target unchanged at EUR 164.0mn for 2009.
- The 1H09 preliminary sales report (sales of EUR 477.9mn, up 2% y/y) confirmed the currency related pressures and slower demand, particularly in the non-core cosmetics and veterinary business. Reflecting the regional currencies' weakening (biting into profitability margins and the financial result), we expect Krka's y/y progress on the operating and bottom lines to be only modest in the period. We envisage Krka's operating profit at EUR 115.4mn (up 6.4% y/y) and net profit at EUR 77.5mn (down 1.0% y/y) in 1H09.

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Changes in forecast/outlook

1H09 sales results confirm anticipated slowdown, despite 2Q receding pressures; regional currencies' weakening major factor

The 1H09 sales highlights provided further evidence of the slowdown of the company's top line tempo this year, due not least to the harmful currency impact. As before, we assume that the second half of the year should see a somewhat bolder performance (with Western European sales propelled by new product introductions). But, while the company sticks to its guidance, we opt for a more cautious stance here. We revise our 2009 sales forecasts downward, as, apart from currency pressures (meanwhile somewhat easing), the company feels (especially in its non-core cosmetics, but also in OTC businesses) the negative impact of the recession and decreasing purchasing power in certain markets, such as Southeast Europe and CIS countries. With their sales growth pace only slightly compromised by the local currency weakness vs. the euro this year, Central European markets should remain the crucial element of Krka's exports this year. In 1H09, the company reported that sales to CEE advanced by some 10% y/y to EUR 136.3mn, representing 29% of its overall group sales. Anticipating the negative currency weakness impact diminishing towards the end of the year, we leave our previously revised 2009 CEE markets sales forecast unchanged at EUR 287.9mn. The sharp currency depreciation and tightening credit situation (hurting wholesalers there), accompanied by lost purchasing power of consumers, has been palpable in the depressed sales to Russia/CIS markets this year. While Krka's 1H09 Russian sales growth tempo remained at a very sound 10% y/y to EUR 86.6mn, the overall Russia/CIS region picture was less rosy, with sales retreating 2% y/y to EUR 117.3mn in 1H09. Still, with the period of steep ruble and hryvnia depreciation over, we think that our revised target for Krka's sales in Russia/CIS of EUR 250.7mn (corresponding to an 8% y/y rise in euro terms) in 2009 is achievable. (Here it is worth mentioning that, in order to smooth its business operations, Krka opted to switch to ruble invoicing from January 2009 for its Russian wholesale partners.) While SEE markets saw relatively depressed levels (attributable partly to difficulties accompanying the adaptation to changes in pharmaceutical market regulation in Romania) already in 2008, the outlook for 2009 is not yet encouraging. SEE markets were recently reported to have dropped by 7% y/y in 1H09 to EUR 63.9mn, indicating that our adjusted 2009 target of EUR 139.5mn might be too ambitious. While the relatively low comparative base bodes well for y/y progress in 2H, we decided to cut our sales forecast here to some EUR 136mn. After a very bold move in Western Europe and Overseas markets in 2008 (when Krka's sales there soared 39% y/y (to EUR 224.3mn, or nearly 24% of 2008 total consolidated sales), the first half of 2009 witnessed a much more modest performance, with sales in Western Europe and Overseas advancing by 1% y/y to EUR 107.6mn. New product launches are envisaged to give a new momentum to Krka's sales in Western Europe in 2H09. Nevertheless, reflecting the weaker than anticipated 1H09 figures, we cautiously reduce our 2009 sales target in this category to EUR 260.2mn (from EUR 268mn).

While we continue to assume 2H rebound and pickup in Western Europe (driven by product launches), we decrease our 2009 sales forecast

All told, we fine-tune our sales target for 2009 to EUR 1043.5mn (vs. our original forecast of EUR 1,054.7mn), translating into a 9.8% y/y rise. (This compares with the current company guidance of EUR 1,062mn.) We revise our consolidated sales forecast for 2010 to around EUR 1,166.6mn, corresponding to 11.8% y/y growth.

Summary of changes to 2009 and 2010 forecasts

EUR mn	2009 orig. forecast		2009 new forecast		2010 orig. forecast		2010 new forecast	
Net sales	1,054.7	100.0%	1,043.5	100.0%	1,190.1	100.0%	1,166.6	100.0%
Costs of good sold	380.3	36.1%	375.2	36.0%	427.9	36.0%	418.4	35.9%
Gross profit	674.4	63.9%	668.3	64.0%	762.2	64.0%	748.2	64.1%
Sales & marketing exp.	272.4	25.8%	267.5	25.6%	307.3	25.8%	299.0	25.6%
Research & development exp.	90.2	8.6%	89.7	8.6%	100.0	8.4%	99.2	8.5%
General & administrative exp.	77.0	7.3%	74.1	7.1%	86.3	7.3%	82.8	7.1%
Other operating income	7.4	0.7%	8.1	0.8%	8.3	0.7%	8.5	0.7%
Operating profit	242.3	23.0%	245.1	23.5%	277.0	23.3%	275.7	23.6%
Financial result	-26.4	-2.5%	-29.2	-2.8%	-14.9	-1.3%	-18.9	-1.6%
Income taxes	51.8	4.9%	51.8	5.0%	60.3	5.1%	60.3	5.2%
Minorities	0.1	0.0%	0.1	0.0%	0.1	0.0%	0.1	0.0%
Net income	164.0	15.5%	164.0	15.7%	201.7	17.0%	196.3	16.8%

Source: Erste Group Research

Sector Report – Erste Sector Healthcare

Reflecting stronger than anticipated 1Q09 operating profitability margin, we lift our EBIT target to EUR 245.1mn...

The 1Q09 gross profit surpassed once again our target (this time by 1.4%), demonstrating that the benefits from the improving sales mix (with an expanding share of new products with higher margins), along with higher economies of scale, more than counterbalanced the negative currency pressures, as well as the need for higher discounts to wholesalers in certain markets. While we expect the above-mentioned factors to remain in place, in order to reflect the better than envisaged results (together with somewhat easing currency related pressures), we slightly increase our gross margin forecast to 64.0% (vs. the reported 65.2% in 1Q09) and see a stable gross margin in 2010 as well (at around 64.1%). Furthermore, except for R&D expenses, all other 1Q09 operating costs were well below our forecasts, calling for an upgrade of our EBIT margin target. While here also we opt to remain on the conservative side, we raise our 2009 operating margin from 23.0% to 23.5%, still corresponding to a y/y decrease in the operating margin. (For comparison, in 2008, the operating margin reached 24.9%). For 2010, we continue to project a minor improvement in the EBIT margin to 23.6%. Reflecting the slight downward adjustment to our top line forecast, we set our new EBIT target at EUR 245.1mn, marginally above the EUR 242.3mn projected earlier. While the company does not plan any significant savings in the area of sales and marketing costs (aiming to expand its sales, in spite of the currently difficult market conditions in certain markets), the 1Q09 sales and marketing costs lagged behind our forecast by 7.7%. Hence, we slightly decrease our sales and marketing costs forecast to 25.6% of total 2009 sales and see them stabilizing in relative terms at around this level in the long run. Also, incorporating the company's cost containment measures (a visible 7.7% y/y cut in administrative costs in 1Q09), we decrease our G&A expenditure forecast from 7.3% to 7.1% of total 2009 sales and assume these costs stabilizing at around the same level in 2010. On the other hand, the company continued its relatively heavy spending in the R&D area. While we stick to our earlier elevated forecast for 2009; for 2010 we raise the projected share of R&D spending in total sales to around 8.5%.

As before, one of the biggest question marks hangs over the level of necessary new provisioning (weighing on sales and marketing costs) and the release of previous provisions (pushing up other income). Here, we remain on the conservative side and anticipate the level of provisioning falling further, albeit only modestly y/y in 2009, from EUR 4.5mn in 2008 to EUR 4.0mn. We also continue to envisage a somewhat lower level of provisions release. However, based on the 1Q09 higher than anticipated result, we increase our other income forecast to EUR 8.1mn (up from EUR 7.4mn) in 2009. Still, the push provided by the release of provisions might be significantly higher. Along with its 1Q09 report, Krka disclosed that the European Patent Office (henceforth EPO) has revoked patent EP 848 705, which refers to the active ingredient atorvastatin. The decision of the EPO board of appeal is final, with Warner Lambert, the patentee, having at its disposal only extraordinary remedies, if it believes that its fundamental procedural rights have been violated or a criminal act might have had an impact on the decision. Krka formed provisions for this case of EUR 87.7mn in 2005-08 (as well as a claim for deferred tax assets of EUR 18.4mn). In the case that the legal litigation is finally over, the provisions will be abolished and Krka's net profit will increase by the difference, i.e. EUR 69.3mn. According to management, it is highly likely that the end of the atorvastatin litigation will come before the end of 2009, although there is no guarantee of this. Consequently, we refrain from factoring in this exceptional boost to Krka's operating line.

...but, factoring in higher forex loss burden on financial result, we stick to our 2009 net profit target of EUR 164.0mn

While the company's exposure to the US dollar dropped significantly last year after the switch to euro (replaced from January 2009 by ruble) invoicing in Russia, the beneficial effect on the forex balance has been as of lately erased by the weakening of regional currencies vs. the euro. Unfortunately, the 1Q09 forex related burden was higher than we originally anticipated, prompting us to make another upward revision of our financial loss assumptions for 2009 (from EUR 26.4mn to EUR 29.2mn). In summary, we stick to our net profit target for 2009 at EUR 164.0mn. As before, we view the company's guidance (net profit of EUR 161mn) as probably too conservative and leaving room for a possible positive surprise. For 2010, reflecting the return of regional currencies to an appreciation path vs. the euro, easing the forex woes, we continue to project solid improvement on the bottom line. We forecast 2010 consolidated net profit at EUR 196.3mn (slightly down from the EUR 201.7mn targeted earlier).

Sector Report – Erste Sector Healthcare

1H09 results preview

As Krka published its 1H09 sales highlights already at the beginning of July, the full 1H09 report (due on July 30, 2009) is not expected to bring any surprises, but rather reassure investors that, while the company did not manage to completely escape the negative impact from the regional markets slowdown (largely driven by currency developments), its tempo in euro terms nevertheless keeps surpassing those of its regional rivals. Although the regional currencies depreciated y/y in 1H09, 2Q09 indicated somewhat easing pressures from the currency side. Still, the top line tempo of Krka (with the euro as its reporting currency) remained confined to low single-digit terms. After Krka's consolidated sales advanced by a mere 0.3% y/y to EUR 245.2mn in 1Q09, the second quarter has brought in sales of EUR 232.7mn (up by 3.5% y/y, but down 5% q/q), lifting the 1H09 total to EUR 477.9mn, up by 2% y/y. Exports rose by 1.7% y/y to EUR 425.1mn, accounting for around 89% of the total consolidated sales in 1H09.

Consolidated sales preview (EUR 000)	2Q2009e	2Q2008	y/y	1H2009e	1H2008	y/y
Slovenia	26,059	26,343	-1.1%	52,812	51,201	3.1%
South-East Europe	31,635	31,184	1.4%	63,908	68,707	-7.0%
Russia/CIS	53,344	58,413	-8.7%	117,314	119,415	-1.8%
Central Europe	64,051	56,900	12.6%	136,288	123,641	10.2%
Western Europe & Overseas	57,635	52,044	10.7%	107,588	106,304	1.2%
IFRS consolidated	2Q2009e	2Q 2008	y/y	1H 2009e	1H 2008	y/y
Total sales (EUR 000)	232,725	224,884	3.5%	477,911	469,268	1.8%
Operating profit (EUR 000)	47,947	45,734	4.8%	115,407	108,478	6.4%
Net income (EUR 000)	33,668	34,226	-1.6%	77,535	78,290	-1.0%
Operating margin	20.6%	20.3%		24.1%	23.1%	
Net margin	14.5%	15.2%		16.2%	16.7%	

Source: Erste Group Research

Although we do not expect Krka to repeat or beat its stellar 1Q09 margins (particularly in the current market environment), we expect that the company will be able to maintain solid profitability parameters in the first half of 2009. Helped by the less pronounced currency-linked pricing pressures and an improving sales mix (namely, an ever-expanding share of new products with higher margins), but still partly compromised by the y/y higher discounts to wholesalers (in certain regional markets, e.g. Russia/CIS), the company has all prerequisites to post progress on the operating line. Provisioning is anticipated to remain at a relatively low level and cost containment measures (particularly in the area of general and administrative expenses) should provide further backup to the results. We forecast Krka's operating profit at EUR 115.4mn in 1H09, a 6.4% rise from the previous year's level. Assuming a q/q improvement in 2Q, but still a significant 1H y/y deterioration in the financial result, we project net profit amounting to EUR 77.5mn in 1H09, down 1.0% y/y.

Valuation summary

Home country continues to benefit Krka's valuation compared to regional peers

Slovenia was the first and, until recently, the only new EU member to adopt the euro (in January 2007). This implies a somewhat lower risk-free rate than we apply for the home countries of Krka's regional peers. With the potential for further downward moves in the yields of government bonds in the EU area rather limited at the moment, we opt to leave our risk-free rate assumptions unchanged at 4.4% for 2009-13. For perpetuity, we continue to apply a risk-free rate of 5%. Similarly to other Krka peers, we use a methodology for setting equity risk premiums, linked to the country's S&P long-term currency rating, introduced in our last sector report in May 2009. This yields an equity risk premium for the explicitly forecast period at 5.0% and for perpetuity at 4.9%. Here, Krka's home country proves to be an advantage in terms of valuation, with Slovenia's AA rating above all other regional countries'. Our calculated WACC arrives at 8.1% for 2009-13 and 9.5% for perpetuity. Incorporating the changing timeframe into our model (compared to our previous report from May 2009), we arrive at a new DCF-derived 12-month target price of EUR 106.5 per share, slightly up from the earlier value of EUR 105.0 per share.

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(Here it is worth mentioning that a rough calculation incorporating the possible release of the atorvastatin case-linked provision into the 2009 results yields a target price of around EUR 108 per share.)

New target price at EUR 106.5 per share

As share price remains at very inviting levels...

... we confirm our Buy recommendation

Although the 1Q09 report brought a positive message, demonstrating that Krka is weathering the currency related pressures, keeping a stable performance on both the top and bottom lines and delivering superior profitability margins, the share price recovery proved to be fragile and the stock appreciation from the earlier lows halted at around EUR 70 per share. While there is no doubt that Krka will see a slowdown from its past year's double-digit tempo this year (due not least to the company's lack of a currency cushion), we believe that Krka continues to represent a very sound investment case. The key arguments remain as follows:

1) Krka's growth in euro terms constantly beats that of its peers and the company's profitability parameters deserve accolades, as they are not only at the region's top, but also the entire industry's.

2) Krka's sales mix is not only well balanced from a territorial perspective, but the high share of new products is the best antidote to pricing pressures, pushing up Krka's margins well above its peers'.

3) Krka's R&D pipeline remains full of generic bestsellers waiting for patent expirations, assuring that the company's success story continues.

4) Unlike its regional peers, Krka keeps - in addition to its traditionally strong regional position (CEE countries, including Russia/CIS) - its solid footing in Western European markets, where it exploits its patent expiration strategy.

5) Krka's balance sheet remains sound; the management investment policies are very prudent and management control systems are very efficient (as evidenced not least by the timely release of financial data, with 1H09 sales announced already on July 2).

While some caveats remain (in particular, in the ailing stock liquidity, which took a hit since the beginning of the financial market crisis), we continue to believe that, at its currently depressed price levels, Krka remains one of the safest (and attractively valued, in the long term perspective) bets in the CEE pharma sector. All told, we reiterate our Buy recommendation on the stock.

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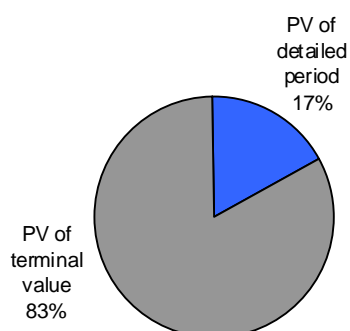
WACC calculation

	2009e	2010e	2011e	2012e	2013e	2014e (TV)
Risk free rate	4.4%	4.4%	4.4%	4.4%	4.4%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	4.9%
Beta	0.8	0.8	0.8	0.8	0.8	1.0
Cost of equity	8.6%	8.6%	8.6%	8.6%	8.6%	9.9%
Cost of debt	5.9%	5.9%	5.9%	5.9%	5.9%	6.5%
Effective tax rate	23.0%	23.0%	23.0%	23.0%	23.0%	20.0%
After-tax cost of debt	4.5%	4.5%	4.5%	4.5%	4.5%	5.2%
Equity weight	87%	87%	87%	87%	87%	91%
WACC	8.1%	8.1%	8.1%	8.1%	8.1%	9.5%

DCF valuation

(EUR mn)	2009e	2010e	2011e	2012e	2013e	2014e (TV)
<i>Sales growth</i>	9.8%	11.8%	12.3%	12.5%	12.7%	8.0%
EBIT	245.1	275.7	310.0	349.7	394.3	385.8
<i>EBIT margin</i>	23.5%	23.6%	23.7%	23.7%	23.7%	21.5%
<i>Tax rate</i>	23.0%	23.0%	23.0%	23.0%	23.0%	20.0%
Taxes on EBIT	-56.4	-63.4	-71.3	-80.4	-90.7	-77.2
NOPLAT	188.7	212.3	238.7	269.2	303.6	308.7
+ Depreciation	79.8	89.0	97.9	107.7	118.5	118.5
<i>Capital expenditures / Depreciation</i>	189.2%	151.3%	131.5%	117.7%	101.8%	100.0%
+/- Change in working capital	-38.9	-45.3	-52.6	-59.6	-67.4	-53.2
<i>Chg. working capital / chg. Sales</i>	-41.6%	-36.8%	-36.6%	-36.3%	-36.0%	-40.0%
- Capital expenditures	-151.1	-134.7	-128.8	-126.7	-120.6	-118.5
Free cash flow to the firm	78.6	121.3	155.2	190.6	234.1	255.5
<i>Terminal value growth</i>						3.5%
Terminal value						4,424.7
Discounted free cash flow - Dec 31 2008	72.7	103.9	123.0	139.8	158.9	2,901.9
Enterprise value - Dec 31 2008	3,500.2					
Minorities	1.8					
Non-operating assets	0.0					
Net debt	186.8					
Other adjustments	0.0					
Equity value - Dec 31 2008	3,311.6					
Number of shares outstanding (mn)	35.4					
Cost of equity	8.6%					
12M target price per share (EUR)	106.5					
Current share price (EUR)	70.0					
<i>Up/Downside</i>	52.2%					

Enterprise value breakdown



Sensitivity (per share)

		Terminal value EBIT margin					
		107	20.5%	21.0%	21.5%	22.0%	22.5%
WACC	8.5%	119.0	122.1	125.3	128.4	131.6	
	9.0%	109.3	112.2	115.0	117.9	120.8	
	9.5%	101.3	103.9	106.5	109.1	111.8	
	10.0%	94.5	96.9	99.3	101.7	104.2	
	10.5%	88.7	90.9	93.1	95.4	97.6	
		Terminal value growth					
		107	2.5%	3.0%	3.5%	4.0%	4.5%
WACC	8.5%	106.5	115.0	125.3	137.8	153.5	
	9.0%	99.3	106.5	115.0	125.3	137.8	
	9.5%	93.1	99.3	106.5	115.0	125.3	
	10.0%	87.8	93.1	99.3	106.5	115.0	
	10.5%	83.1	87.8	93.1	99.3	106.5	

Source: Erste Group Research

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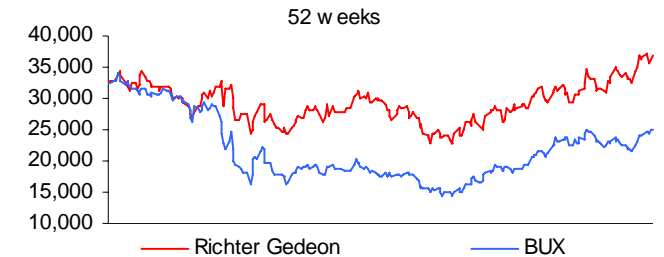
Income Statement	2006	2007	2008	2009e	2010e	2011e
(IAS, EUR mn, 31/12)	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2011
Net sales	667.95	780.92	949.92	1,043.48	1,166.57	1,310.36
Cost of goods sold	-248.99	-282.83	-325.10	-375.16	-418.36	-469.22
Gross profit	418.97	498.09	624.82	668.32	748.21	841.14
SG&A	-219.39	-259.10	-311.91	-341.55	-381.84	-428.91
Other operating revenues	3.56	3.73	8.62	8.09	8.46	9.17
Other operating expenses	-52.65	-59.07	-84.75	-89.74	-99.16	-111.38
EBITDA	198.20	240.59	308.39	324.96	364.69	407.95
Depreciation/amortization	-47.70	-56.94	-71.61	-79.84	-89.03	-97.93
EBIT	150.50	183.64	236.78	245.12	275.66	310.02
Financial result	-1.74	-8.71	-31.15	-29.20	-18.95	-16.52
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	148.76	174.93	205.63	215.92	256.72	293.50
Income taxes	-36.67	-42.08	-49.74	-51.82	-60.33	-67.51
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-0.41	-0.30	0.06	-0.07	-0.08	-0.09
Net result after minorities	111.68	132.55	155.96	164.03	196.31	225.90
Balance Sheet	2006	2007	2008	2009e	2010e	2011e
(IAS, EUR mn, 31/12)						
Intangible assets	23.61	129.85	128.98	127.53	126.15	124.85
Tangible assets	506.82	572.24	638.33	714.93	800.73	896.81
Financial assets	44.42	47.61	44.84	56.06	70.07	94.59
Total fixed assets	574.85	749.71	812.16	898.52	996.95	1,116.25
Inventories	115.93	171.65	211.66	230.18	254.76	283.30
Receivables and other current assets	177.96	184.54	239.61	267.45	297.87	333.35
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	10.40	15.78	7.60	9.51	12.36	16.06
Total current assets	304.28	371.97	458.88	507.14	564.99	632.72
TOTAL ASSETS	879.13	1,121.68	1,271.04	1,405.66	1,561.94	1,748.97
Shareholders'equity	563.00	670.88	781.47	913.26	1,072.37	1,259.31
Minorities	7.91	10.04	1.82	1.82	1.82	1.82
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
Other LT provisions	122.55	143.64	149.66	147.42	140.05	133.04
Interest-bearing LT debts	34.58	87.18	83.73	79.55	71.59	60.85
Other LT liabilities	6.80	21.56	24.13	22.92	15.51	13.18
Total long-term liabilities	41.39	108.74	107.86	102.47	87.10	74.03
Interest-bearing ST debts	55.79	66.14	110.64	121.54	128.11	130.68
Other ST liabilities	88.49	122.25	119.57	119.14	132.48	150.09
Total short-term liabilities	144.28	188.39	230.21	240.68	260.60	280.77
TOTAL LIAB. , EQUITY	879.13	1,121.68	1,271.04	1,405.66	1,561.94	1,748.97
Cash Flow Statement	2006	2007	2008	2009e	2010e	2011e
(IAS, EUR mn, 31/12)						
Cash flow from operating activities	140.63	175.20	150.23	185.72	185.29	190.22
Cash flow from investing activities	-111.54	-204.95	-192.01	-151.09	-134.72	-128.82
Cash flow from financing activities	-30.97	35.14	-6.48	-32.73	-47.72	-57.69
CHANGE IN CASH , CASH EQU.	-1.87	5.39	-48.26	1.90	2.85	3.71
Margins & Ratios	2006	2007	2008	2009e	2010e	2011e
Sales growth	20.5%	16.9%	21.6%	9.8%	11.8%	12.3%
EBITDA margin	29.7%	30.8%	32.5%	31.1%	31.3%	31.1%
EBIT margin	22.5%	23.5%	24.9%	23.5%	23.6%	23.7%
Net profit margin	16.8%	17.0%	16.4%	15.7%	16.8%	17.2%
ROE	21.6%	21.5%	21.5%	19.4%	19.8%	19.4%
ROCE	15.6%	15.4%	15.3%	14.0%	15.0%	15.4%
Equity ratio	64.9%	60.7%	61.6%	65.1%	68.8%	72.1%
Net debt	80.0	137.5	186.8	191.6	187.4	175.5
Working capital	160.0	183.6	228.7	266.5	304.4	352.0
Capital employed	780.2	983.6	1,143.9	1,277.0	1,417.1	1,582.8
Inventory turnover	2.1	2.0	1.7	1.7	1.7	1.7

Source: Company data, Erste Group estimates

Richter Gedeon from Buy to Accumulate

Vladimira Urbankova, MBA +43 50100 17343 vladimira.urbankova@erstegroup.com

HUF mn	2008	2009e	2010e	2011e
Net sales	236,518.0	262,641.2	276,794.9	302,058.5
EBITDA	54,739.0	66,312.4	71,555.6	80,856.2
EBIT	34,156.0	45,162.8	48,409.7	55,376.9
Net result after min.	41,410.0	46,824.5	47,955.2	55,016.1
EPS (HUF)	2,221.87	2,512.39	2,573.05	2,951.91
CEPS (HUF)	3,326.25	3,647.17	3,814.95	4,319.00
BVPS (HUF)	18,054.96	19,916.11	21,789.16	23,941.06
Div./share (HUF)	590.00	650.00	700.00	800.00
EV/EBITDA (x)	8.4	8.9	7.8	6.5
P/E (x)	12.8	14.7	14.3	12.5
P/CE (x)	8.5	10.1	9.7	8.5
Dividend Yield	2.1%	1.8%	1.9%	2.2%



Performance	12M	6M	3M	1M
in HUF	13.2%	24.7%	30.2%	12.5%
in EUR	-1.7%	34.9%	43.8%	16.8%

Share price (HUF)	36900.00	Reuters	GDRB.BU	Free float	74.6%
Number of shares (mn)	18.6	Bloomberg	RICHT HB	Shareholders	Hungarian State (25.1%)
Market capitalization (HUF mn / EUR mn)	687,723 / 2,570	Div. Ex-date	04/06/09		
Enterprise value (HUF mn / EUR mn)	590,621 / 2,208	Target price	41,900.0	Homepage:	www.richter.hu

Safe bet in challenging times

- With its healthy balance sheet (featuring a heavy cash pile), sound long-term business outlook (backed by its excellent territorial and product niche strategy, as well as potential boost from its R&D and biotech foray) and solid stock liquidity, Richter remains highly attractive, despite the challenging equity market conditions. Although the forint already appreciated and left its historical lows, Richter is still set to be one of the beneficiaries from the y/y weakening of its home currency in 2009. The news flow on R&D cooperation on CNS drugs with Forest Laboratories continues to represent a possible trigger for the stock in the near term. Although the relatively high equity risk premium attached to its Hungarian home puts the stock at a relative disadvantage, our DCF-derived 12-month target price of HUF 41,900 per share points to untapped upside potential. Nevertheless, with the narrowing distance to our target price (after the recent rally), we downgrade our recommendation on Richter from Buy to Accumulate.
- The most important factors newly incorporated into our model include the following: 1) the somewhat more sluggish than earlier anticipated tempo in certain CEE markets (namely Poland), the increasing competitive pressure dampening Western European sales; 2) the beneficial impact from the milestone payment from Forest Laboratories, as well as the government subsidy granted for biotech investment; 3) the slightly faster than earlier envisaged forint appreciation, with a resulting revision of average exchange rates for 2009 and 2010. All this sends our new consolidated net profit target for 2009 to HUF 46,825mn, on sales of HUF 262,641mn, down 0.5% and 3.5%, respectively, compared to our previous forecasts. For 2010, we set a new net profit target of HUF 47,955mn, on sales of HUF 276,795mn.
- As per tradition, Richter did not announce the exact date for its 2Q09 report; it is expected to deliver it in the second week of August. We forecast Richter's consolidated sales advancing by 24.4% y/y to HUF 71,909mn in 2Q09. The recovery in Russia is envisaged to be complemented by y/y accelerating US sales, as well as easing currency related pressures in CEE markets. On the other hand, as the forint halted in its steep fall, the financial result cushion will decrease significantly q/q. Nevertheless, with respect to the year-earlier low comparative base, we project a net profit rise of 116.5% y/y in 2Q09.

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Changes in forecasts/outlook

Domestic market stabilizing, drospirenone contract beneficial impact on US sales to bolster exports in 2009

Domestic market: The first quarter results reassured investors that Richter's home market no longer represents a source of worry. Although the pricing pressures related to the quarterly updated changes in reference prices continue to put a lid on Richter's domestic sales, the negative effect is getting less and less significant over time. Thanks to a low comparative base, coupled with certain inventory buildup ahead of scheduled trimming of reimbursement rates for several key prescription drugs (among them Cavinton) from April 1, 2009, Richter's domestic sales surged 15.1% y/y in 1Q09. With the reimbursement cut raising patients' co-payments by up to 33%, lower demand is anticipated for the rest of the year. Consequently, while the 1Q09 results were ahead of our forecasts, we opt to stick to our earlier assumption of a 2% y/y rise and our 2009 consolidated domestic sales target of HUF 31.2bn. For 2010, we remain cautiously optimistic and continue to project low single-digit growth in Richter's domestic sales, by 3% y/y to HUF 32.1bn.

EU: As other regional currencies (apart from the Russian ruble and Ukrainian hryvnia, also the Polish zloty and Romanian leu) depreciated at an even faster pace than the forint and the company was facing mounting competitive pressures in Western Europe, Richter's exports were significantly compromised in 1Q09. While 1Q09 sales to the EU as a total were only slightly lagging our behind forecasts, incorporating worse than anticipated performance in the key Polish market, as well as the deteriorating outlook for Western European sales, we cut our forecast for sales to the EU and expect them to drop by around 3% y/y to EUR 377.9mn in 2009 (down from the earlier estimate of EUR 396.8mn, assuming a 2% y/y rise). (Here its worth mentioning that we are still slightly more optimistic than the company's guidance of a 10% y/y drop for EU9 and a 5% y/y decline for EU15, all in euro terms.) For 2010, we project a recovery, with sales there advancing 12% y/y to EUR 424mn.

Russia/CIS: The 1Q09 Russia/CIS sales tempo was broadly in line with our expectations (tempered by bad news arriving in the course of the first months of 2009). While the company's guidance assumes a practically unchanged (i.e. gloomy) situation in Ukraine and other CIS markets (with a 40% to 50% y/y slump in Ukraine and a 10% fall for the other CIS countries), as well as a drop in Russia (by some 5% to 10%), the news flow from Russia is not as pessimistic as before (due not least to the currency stabilization). Hence, we stick to our slightly more optimistic stance going forward. Particularly in Russia, Richter is poised for improvement (with the ruble halting its fall and agreements with wholesalers on a mechanism for sharing losses / risks from currency depreciation boding well for Richter's Russian business proceeding without interruptions like those experienced in January of this year). All told, for Russia alone, we leave our 2009 sales forecast unchanged at around EUR 200mn, corresponding to a 3% y/y rise (which might prove to be too conservative). While the situation in other CIS markets is still far less satisfactory, with problems reported in Kazakhstan and (even more dramatically) in Ukraine, we continue to believe that our Russia/CIS sales target of EUR 283.3mn in 2009 (translating into a 3.3% y/y drop in EUR terms) is realistic. For 2010, we stick to our sales target for Russia/CIS of EUR 311.6mn (corresponding to a 10% y/y rise).

US: The 1Q09 results demonstrated clearly the buoying effect of the profit-sharing arrangement with Barr Laboratories on drospirenone. As this was already reflected in our adjusted forecast from May 2009, we leave our US sales target broadly unchanged at EUR 104.5mn for 2009. Finally, we factor in the new exchange rate forecast, revising the average exchange rate from HUF 202.0/USD to HUF 199.1/USD for 2009, and from an average exchange rate of HUF 288.8/EUR to HUF 283.8/EUR for 2009. For 2010, we revise our forecast from the average exchange rate of HUF 189.7/USD to HUF 186.2/USD and from the average exchange rate of HUF 275/EUR to HUF 270/EUR. After incorporating all of the above-mentioned changes, our consolidated sales target for 2009 arrives at HUF 262.6bn, slightly below the previous forecast of HUF 272.2bn, with some HUF 41.6bn to be delivered by wholesale and retail operations and HUF 221.0bn to be contributed by the pharmaceutical business segment. For 2010, our new consolidated sales target is HUF 276.8bn (down from the earlier HUF 288.9bn), out of which HUF 232.0bn is expected to come from the pharmaceutical segment and HUF 44.8bn from the wholesale and retail arm.

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Summary of changes to 2009 and 2010 consolidated forecasts

(HUF mn)	2009 orig. forecast		2009 new forecast		2010 orig. forecast		2010 new forecast	
Sales	272,177	100.0%	262,641	100.0%	288,899	100.0%	276,795	100.0%
Cost of sales	120,401	44.2%	116,182	44.2%	127,159	44.0%	121,831	44.0%
Gross profit	151,777	55.8%	146,459	55.8%	161,740	56.0%	154,964	56.0%
Sales and marketing costs	58,518	21.5%	56,468	21.5%	62,113	21.5%	59,511	21.5%
Admin. and general costs	18,236	6.7%	17,597	6.7%	19,356	6.7%	18,268	6.6%
R&D costs	21,774	8.0%	22,587	8.6%	23,112	8.0%	23,666	8.6%
Other income/expense	-7,844	-2.9%	-4,644	-1.8%	-7,222	-2.5%	-5,109	-1.8%
Operating profit	45,404	16.7%	45,163	17.2%	49,936	17.3%	48,410	17.5%
Net financial income	5,389	2.0%	5,384	2.0%	3,154	1.1%	3,362	1.2%
Taxation	3,556	1.3%	3,538	1.3%	3,716	1.3%	3,624	1.3%
Minorities	-184	-0.1%	-184	-0.1%	-193	-0.1%	-193	-0.1%
Net profit	47,054	17.3%	46,825	17.8%	49,181	17.0%	47,955	17.3%

Source: Erste Group Research

Weakening forint to bolster profitability margins

Bolstered by the more favorable currency situation (with the y/y sharp weakening of the Hungarian forint vs. the EUR and USD), Richter's consolidated profitability parameters improved significantly in 1Q09. Nevertheless, a closer look at the data suggests that the progress lagged slightly behind our targets on both the gross level and - stripping out the one-off positive effect from milestone payments from Forest Laboratories and a government subsidy grant for biotechnology investment (totaling together some HUF 2.2bn) - on the operating line. It is apparent that, in the current market circumstances, the company's goal to shore up the profitability of its wholesale and retail business arm (including its Romanian business operations, acquired in 2007), lifting it to break-even, has become ever-more distant. Also, the operating costs of sales and marketing-focused subsidiaries abroad continue to weigh on consolidated margins, keeping them well below that of the parent company. While the gross margin in 1Q09 was slightly less robust than we had forecast, with respect to the anticipated recovery in high-margin Russian sales, we stick to our consolidated gross margin target of 55.8%. For 2010, we see a gross margin target improvement to 56.0% as realistic. While sales and marketing expenditures were more modest than we expected, reflecting the company's unchanged guidance, as well as the return of the sales rep fees in Hungary from mid-February 2009, we opt to leave our 2009 targets unchanged in relative terms and continue to forecast the sales and marketing costs at around 21.5% of consolidated sales for full-year 2009. Pushed up by the unfavorable currency situation (with part of the costs incurred in US dollars), research and development costs exceeded our projections in 1Q09 by a wide margin. While the final 2009 bill will (apart from currency developments) also depend on the speed of the progress of the clinical trials in cooperation with Forest Laboratories, we opt to raise our target here and forecast R&D expenses reaching around 8.6% of consolidated 2009 sales (up from the earlier forecast of 8.0% of sales). On the other hand, with the additional income, milestone payments from Forest Laboratories and the government subsidy linked to biotech investment, the other income / expense balance should be a less negative item than we originally projected. In summary, our new operating profit target arrives at HUF 45,163mn for 2009, translating into a consolidated operating profit margin of 17.2%, up slightly from the earlier projected 16.7%. For 2010, we see an operating margin of 17.5% as achievable.

1Q09 provided further evidence of the profound currency fortune-driven financial result's impact on Richter's bottom line. The first quarter net financial income of HUF 9.75bn even surpassed the previous 4Q08 record gains (HUF 7.7bn). Although the 1Q09 boost on the consolidated level was more robust than we expected, the structure of the result (with HUF 4,185mn out of the HUF 9,746mn result representing unrealized financial items) and anticipated currency developments this year point to a cautious approach going forward, with high profits unlikely to be repeated in coming periods. Moreover, already 2Q09 is likely to erase a large part of the 1Q09 financial gains. Despite the strong 1Q09 showing, we stick to our original forecast - net financial income of HUF 5.4bn in 2009. In summary, assuming an effective tax rate of 7% (due to the higher statutory tax rates abroad compared to Richter's near-tax haven in Hungary), our new

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consolidated net profit target arrives at HUF 46,825mn for 2009. For 2010, we forecast Richter's consolidated net profit advancing by 2.4% y/y to HUF 47,955mn.

2Q09 results preview

Richter is expected to announce its 2Q09 results in the second week of August 2009 (no precise date is known yet). We expect 2Q09 net profit of HUF 6,307mn on sales of HUF 71,909mn (consolidated and according to IFRS standards). On the unconsolidated basis, we project net profit at HUF 3,200mn on sales of HUF 55,668mn.

Consolidated sales preview	2Q2009e	2Q2008	y/y	1H2009e	1H2008	y/y
Hungary (HUF bn)	7.327	7.431	-1.4%	15.868	14.853	6.8%
USA (EUR mn)	30.8	17.9	72.2%	53.2	28.9	84.1%
EU (EUR mn)	92.1	97.0	-5.0%	177.0	192.2	-7.9%
Russia, CIS (EUR mn)	90.5	75.6	19.7%	150.1	148.3	1.2%
Other (EUR mn)	12.5	12.9	-3.3%	23.5	25.2	-6.8%
Total export (EUR mn)	225.9	203.4	11.1%	403.8	394.6	2.3%
IFRS consolidated	2Q2009e	2Q2008	y/y	1H2009e	1H2008	y/y
Total sales (HUF mn)	71,909	57,808	24.4%	133,247	114,834	16.0%
Operating profit (HUF mn)	14,733	9,182	60.5%	27,170	19,278	40.9%
Net income (HUF mn)	6,307	2,913	116.5%	27,879	13,134	112.3%
Operating margin	20.5%	15.9%		20.4%	16.8%	
Net margin	8.8%	5.0%		20.9%	11.4%	

Source: Erste Group Research

While the home market pricing pressures are easing and the comparative base plays in the company's favor, the 2Q09 performance is likely to be hampered by the regulatory changes, with the associated inventory pickup ahead of the April 2009 cut in reimbursement to be followed by a period of sluggish sales. Consequently, we anticipate Richter's consolidated domestic sales retreating by a relatively modest 1.4% y/y (falling 14.2% q/q) to HUF 7.3bn in 2Q09. After the hefty 15.1% y/y sales rise in 1Q09, we expect Richter's domestic sales tempo to slow down to 6.8% y/y in the first half of 2009. On the other hand, Richter's 2Q09 exports are set to show a somewhat more pleasing picture than in the first quarter. Reflecting the regional currencies' appreciation vs. the euro, export sales in euro terms are anticipated to get additional support in most of the export territories in 2Q09. While drug price increases are still insufficient to catch up with the y/y currency weakening, the situation in the Russian market is far less critical and sales in Russia are expected to pick up strongly, by 64.6% q/q (and 35.3% y/y) in EUR terms to EUR 67.0mn in 2Q09. While other CIS markets (particularly Ukraine and Kazakhstan) are still in the doldrums, witnessing the dramatically negative effect of the financial crisis on local purchasing power (further magnified by currency woes), pushed up by the Russian revival, Richter's Russia/CIS sales are expected to surge by 19.7% y/y to EUR 90.5mn in 2Q09. The EU area is likely to show only slight q/q improvement. Helped by the relative 2Q strengthening of regional currencies (in particular, the PLN and RON), but still hampered by pricing pressures in the West, we project Richter's sales there declining by 5.0% in EUR terms (to EUR 92.1mn), translating into a 9.7% y/y increase in forint terms. The US sales performance is envisaged to remain stellar in 2Q09. Fueled by benefits from the profit-sharing agreement on drospirenone (and helped by the year-earlier low comparative base), US sales are forecasted to climb by 72.2% y/y to EUR 30.8mn in 2Q09. In summary, we project Richter's exports increasing by 11.1% y/y in EUR terms in 2Q09. Reflecting the supportive effect of the y/y weakening of the Hungarian forint, we envisage Richter's consolidated sales advancing by a relatively hefty 24.4% y/y to HUF 71.9bn in 2Q09. We forecast an unconsolidated sales rise of around 28% y/y to HUF 55.7bn in 2Q09.

Importantly, in 2Q09, currency developments were still favorable for Richter's profitability margins, with the average HUF/EUR exchange rate at 285.86 in 2Q09 (vs. the average of 247.9 in 2Q08). Although 2Q08 represents a relatively high comparative base, y/y progress should be in the cards. The favorable currency fortunes were further augmented by an improving sales mix,

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namely expanding sales to Russia and benefits from the drospirenone profit-sharing agreement (boosting the top line, while having no associated costs). Consequently, on the consolidated level, we project operating profit reaching HUF 14,733mn (up 60.5% y/y), with a corresponding EBIT margin of 20.5% in 2Q09 (this compares with an EBIT margin of 15.9% in 2Q08). Nevertheless, the closing exchange rate as of June 30, 2009, of HUF/EUR 272.4, was far less advantageous than the 307.5 seen on March 31, 2009, indicating a significant turn for the worse in a q/q comparison for Richter's financial result. Still, the previous year's comparative base (with the worst interim financial result of the 2008 year, an HUF 5.8bn financial loss) limits the room for y/y deterioration as well. We project the 2Q09 consolidated financial result diving into the red, to an HUF 8.1bn loss, but still (thanks to the EBIT jump) allowing for a bold bottom line upward move, a rise of 116.5% y/y to HUF 6,307mn. On the unconsolidated basis, we forecast 2Q09 EBIT of HUF 13,748mn, translating into an EBIT margin of 24.7%, well above the year-earlier level of 20.0%. Our unconsolidated 2Q09 net profit target is at HUF 3,200mn (up from net profit of HUF 966mn in 1H08).

Valuation summary

We adjust our DCF model parameters to reflect decreasing government bond yields

Finally, we have reviewed the parameters of our DCF model. In line with our previous sector report from May 2009, we use the new methodology for setting equity risk premiums, based on S&P long-term currency ratings; with no major changes in the home country ratings, we stick to the equity risk premium of 6.75% for the explicit forecast period of 2009-13, and to 6.3% for perpetuity. This, along with our fine-tuned risk-free rate assumption (mirroring decreasing yields on Hungarian government bonds as of lately, changed from 9.0% to 8.5% for the detailed forecast period of 2009-13), leads to a WACC of 14.1% for 2009-13 and 11.3% for perpetuity. All told, reflecting the only slightly lessening "penalty" for its Hungarian home, our DCF-derived 12-month target price arrives at HUF 41,900 per share, somewhat above our earlier target of HUF 38,990 per share. As before, we believe that the bias is on the upward side. While the decision of the Hungarian government to pay off EUR 639mn worth of Richter convertible bonds at expiry (September 28, 2009) and to refinance them with issuance of new convertible bonds largely removed the short-term speculation flavor of the stock, Richter's fundamentals remain very strong and its long-term story, based on the exploitation its product and territorial niche, should see enrichment with new interesting elements. Most importantly, the company may enjoy benefits from its R&D cooperation projects with Forest Laboratories, or from its recent foray into the biotech field. We want to emphasize that none of these potential positive stock and valuation triggers are adequately reflected in our model, due to the lack of relevant data. However, this will definitely become an important addition to the target price. Furthermore, the home market financial market situation is also foreseen to improve in the medium term, at least, allowing for a reduction of the applied risk parameters and providing for another lift to the target price. All told, we continue to believe that, despite its recent firming, Richter's current share price offers attractive long-term upside potential. Positive news flow regarding R&D programs in cooperation with Forest Laboratories (with more data from the clinical phase II trials on RGH 188 in schizophrenia patients anticipated in autumn this year) represents another impetus for the stock performance. Nevertheless, with the somewhat narrowing upside potential (after the recent rally), we downgrade our recommendation on Richter from Buy to Accumulate.

While we raise our 12-month target price to HUF 41,900 per share, we downgrade recommendation from Buy to Accumulate

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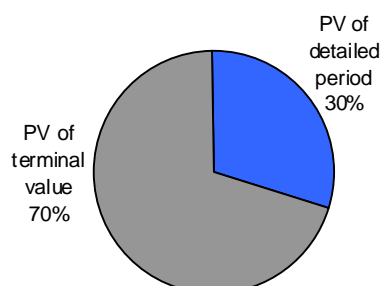
WACC calculation

	2009e	2010e	2011e	2012e	2013e	2014e (TV)
Risk free rate	8.5%	8.5%	8.5%	8.5%	8.5%	5.0%
Equity risk premium	6.75%	6.75%	6.75%	6.75%	6.75%	6.3%
Beta	0.8	0.8	0.8	0.8	0.8	1.0
Cost of equity	14.2%	14.2%	14.2%	14.2%	14.2%	11.3%
Cost of debt	10.0%	10.0%	10.0%	10.0%	10.0%	6.5%
Effective tax rate	7.0%	7.0%	7.0%	7.0%	12.0%	20.0%
After-tax cost of debt	9.3%	9.3%	9.3%	9.3%	8.8%	5.2%
Equity weight	99%	99%	99%	99%	99%	99%
WACC	14.1%	14.1%	14.1%	14.1%	14.1%	11.3%

DCF valuation

(HUF mn)	2009e	2010e	2011e	2012e	2013e	2014e (TV)
<i>Sales growth</i>	11.0%	5.4%	9.1%	9.2%	9.2%	8.0%
EBIT	45,162.8	48,409.7	55,376.9	62,869.0	70,569.6	77,757.4
<i>EBIT margin</i>	17.2%	17.5%	18.3%	19.1%	19.6%	20.0%
<i>Tax rate</i>	7.0%	7.0%	7.0%	7.0%	12.0%	20.0%
Taxes on EBIT	-3,161.4	-3,388.7	-3,876.4	-4,400.8	-8,468.3	-15,551.5
NOPLAT	42,001.4	45,021.0	51,500.5	58,468.2	62,101.2	62,205.9
+ Depreciation	21,149.6	23,145.9	25,479.3	28,012.6	30,845.9	30,845.9
<i>Capital expenditures / Depreciation</i>	93.6%	96.3%	96.3%	96.3%	96.4%	100.0%
+/- Change in working capital	-1,137.7	-1,241.5	-2,200.4	-2,557.8	-2,976.0	-2,879.9
<i>Chg. working capital / chg. Sales</i>	-4.4%	-8.8%	-8.7%	-9.3%	-9.8%	-10.0%
- Capital expenditures	-19,804.4	-22,293.3	-24,542.6	-26,978.1	-29,728.7	-30,845.9
Free cash flow to the firm	42,208.9	44,632.2	50,236.8	56,944.9	60,242.4	59,326.0
<i>Terminal value growth</i>						3.5%
Terminal value						791,209.9
Discounted free cash flow - Dec 31 2008	36,986.0	34,270.1	33,800.4	33,572.9	31,123.5	394,945.9
Enterprise value - Dec 31 2008	564,698.8					
Minorities	2,787.0					
Non-operating assets	0.0					
Net debt	-71,195.0					
Other adjustments	0.0					
Equity value - Dec 31 2008	633,106.8					
Number of shares outstanding (mn)	18.6					
Cost of equity	14.2%					
12M target price per share (HUF)	41900					
Current share price (HUF)	36900					
<i>Up/Downside</i>	13.6%					

Enterprise value breakdown



Sensitivity (per share)

		Terminal value EBIT margin				
		19.0%	19.5%	20.0%	20.5%	21.0%
WACC	41900					
	10.3%	44,193	44,980	45,766	46,553	47,339
	10.8%	42,235	42,968	43,700	44,432	45,165
	11.3%	40,530	41,215	41,900	42,585	43,270
	11.8%	39,030	39,674	40,318	40,962	41,605
12.3%	37,702	38,309	38,916	39,523	40,130	
		Terminal value growth				
		2.5%	3.0%	3.5%	4.0%	4.5%
WACC	41900					
	10.3%	41,900	43,700	45,766	48,163	50,975
	10.8%	40,318	41,900	43,700	45,766	48,163
	11.3%	38,916	40,318	41,900	43,700	45,766
	11.8%	37,666	38,916	40,318	41,900	43,700
12.3%	36,544	37,666	38,916	40,318	41,900	

Source: Erste Group Research

Sector Report – Erste Sector Healthcare

Income Statement	2006	2007	2008	2009e	2010e	2011e
(IAS, HUF mn, 31/12)	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2011
Net sales	209,373.00	224,076.00	236,518.00	262,641.21	276,794.91	302,058.53
Cost of goods sold	-89,704.00	-104,379.00	-108,421.00	-116,182.15	-121,830.97	-132,352.45
Gross profit	119,669.00	119,697.00	128,097.00	146,459.07	154,963.94	169,706.08
S G&A	-53,050.00	-58,208.00	-67,886.00	-74,064.82	-77,779.37	-83,821.24
Other operating revenues	0.00	0.00	0.00	0.00	0.00	0.00
Other operating expenses	-17,092.00	-25,206.00	-26,055.00	-27,231.47	-28,774.88	-30,507.91
EBITDA	68,276.00	56,496.00	54,739.00	66,312.37	71,555.62	80,856.20
Depreciation/amortization	-18,749.00	-20,213.00	-20,583.00	-21,149.60	-23,145.93	-25,479.27
EBIT	49,527.00	36,283.00	34,156.00	45,162.77	48,409.68	55,376.93
Financial result	2,586.00	-503.00	9,297.00	5,383.73	3,362.41	3,997.93
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	52,113.00	35,780.00	43,453.00	50,546.50	51,772.09	59,374.86
Income taxes	-711.00	-1,809.00	-1,876.00	-3,538.26	-3,624.05	-4,156.24
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-124.00	-635.00	-167.00	-183.70	-192.89	-202.53
Net result after minorities	51,278.00	33,336.00	41,410.00	46,824.55	47,955.16	55,016.09
Balance Sheet	2006	2007	2008	2009e	2010e	2011e
(IAS, HUF mn, 31/12)						
Intangible assets	6,049.00	11,639.00	15,636.00	12,008.40	13,962.47	15,683.20
Tangible assets	136,049.00	144,863.00	141,935.00	143,486.00	144,086.00	145,086.00
Financial assets	18,579.00	18,985.00	13,486.00	14,160.30	14,797.51	15,944.32
Total fixed assets	160,677.00	175,487.00	171,057.00	169,654.70	172,845.98	176,713.52
Inventories	52,716.00	52,874.00	56,808.00	57,089.57	57,759.47	58,619.10
Receivables and other current assets	53,272.00	64,371.00	79,950.00	83,110.12	85,307.42	89,550.12
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	59,119.00	55,231.00	76,318.00	105,327.56	135,285.09	169,077.59
Total current assets	165,107.00	172,476.00	213,076.00	245,527.24	278,351.99	317,246.81
TOTAL ASSETS	325,784.00	347,963.00	384,133.00	415,181.94	451,197.97	493,960.33
Shareholders'equity	288,115.00	306,183.00	336,499.00	371,186.18	406,095.10	446,201.20
Minorities	5,813.00	8,198.00	2,787.00	2,856.68	2,899.53	2,943.02
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
Other LT provisions	0.00	0.00	0.00	0.00	0.00	0.00
Interest-bearing LT debts	710.00	463.00	70.00	63.00	58.91	54.49
Other LT liabilities	1,775.00	1,249.00	1,029.00	771.75	578.81	434.11
Total long-term liabilities	2,485.00	1,712.00	1,099.00	834.75	637.72	488.60
Interest-bearing ST debts	184.00	392.00	5,053.00	5,305.65	4,775.09	4,297.58
Other ST liabilities	29,187.00	31,478.00	38,695.00	34,998.68	36,790.54	40,029.94
Total short-term liabilities	29,371.00	31,870.00	43,748.00	40,304.33	41,565.62	44,327.51
TOTAL LIAB. , EQUITY	325,784.00	347,963.00	384,133.00	415,181.94	451,197.97	493,960.33
Cash Flow Statement	2006	2007	2008	2009e	2010e	2011e
(IAS,HUF mn, 31/12)						
Cash flow from operating activities	55,501.00	47,736.00	42,417.00	60,682.70	65,831.74	73,726.97
Cash flow from investing activities	-24,150.00	-30,931.00	-35,429.00	-19,804.43	-22,293.30	-24,542.56
Cash flow from financing activities	-12,644.00	-18,137.00	2,131.00	-11,868.72	-13,580.90	-15,391.92
CHANGE IN CASH , CASH EQU.	18,057.00	-1,377.00	7,625.00	29,009.56	29,957.54	33,792.50
Margins & Ratios	2006	2007	2008	2009e	2010e	2011e
Sales growth	21.3%	7.0%	5.6%	11.0%	5.4%	9.1%
EBITDA margin	32.6%	25.2%	23.1%	25.2%	25.9%	26.8%
EBIT margin	23.7%	16.2%	14.4%	17.2%	17.5%	18.3%
Net profit margin	24.6%	15.2%	17.6%	17.9%	17.4%	18.3%
ROE	19.2%	11.2%	12.9%	13.2%	12.3%	12.9%
ROCE	22.3%	12.6%	14.5%	16.6%	16.4%	18.4%
Equity ratio	90.2%	90.3%	88.3%	90.1%	90.6%	90.9%
Net debt	-58,225.0	-54,376.0	-71,195.0	-99,958.9	-130,451.1	-164,725.5
Working capital	135,736.0	140,606.0	169,328.0	205,222.9	236,786.4	272,919.3
Capital employed	237,478.0	261,254.0	269,120.0	274,855.7	279,122.3	284,852.8
Inventory turnover	1.8	2.0	2.0	2.0	2.1	2.3

Source: Company data, Erste Group estimates

Sector Report – Erste Sector Healthcare

Contacts

Group Research

Head of Group Research

Friedrich Mostböck, CEFA +43 (0)5 0100 - 11902

CEE Equity Research

Co-Head: Günther Artner, CFA +43 (0)5 0100 - 11523

Co-Head: Henning Eßkuchen +43 (0)5 0100 - 19634

Günther Hohberger (Banks) +43 (0)5 0100 - 17354

Franz Hörl, CFA (Steel, Construction) +43 (0)5 0100 - 18506

Gernot Jany, CFA (Banks, Real Estate) +43 (0)5 0100 - 11903

Daniel Lion, CIIA (IT) +43 (0)5 0100 - 17420

Martina Valenta, MBA (Transp., Paper) +43 (0)5 0100 - 11913

Christoph Schultes, CIIA (Ins., Util.) +43 (0)5 0100 - 16314

Thomas Unger +43 (0)5 0100 - 17344

Vera Suttedja, CFA (Telecom) +43 (0)5 0100 - 11905

Vladimira Urbankova, MBA (Pharma) +43 (0)5 0100 - 17343

Gerald Walek, CFA (Machinery) +43 (0)5 0100 - 16360

International Equities

Hans Engel (Market strategist) +43 (0)5 0100 - 19835

Stephan Lingnau (Europe) +43 (0)5 0100 - 16574

Ronald Stöferle (Asia) +43 (0)5 0100 - 11723

Macro/Fixed Income Research

Head: Gudrun Egger, CEFA (Euroland) +43 (0)5 0100 - 11909

Alihan Karadagoglu (Corporates) +43 (0)5 0100 - 19633

Rainer Singer (US) +43 (0)5 0100 - 11185

Elena Statelov, CIIA (Corporates) +43 (0)5 0100 - 19641

Mildred Hager (SW, Japan) +43 (0)5 0100 - 17331

Macro/Fixed Income Research CEE

Co-Head CEE: Juraj Kotian (Macro/FI) +43 (0)5 0100 - 17357

Co-Head CEE: Rainer Singer (Macro/FI) +43 (0)5 0100 - 11185

Editor Research CEE

Brett Aarons +420 223 005 904

Research, Croatia/Serbia

Head: Mladen Dodig +381 11 22 00 866

Damir Cukman (Equity) +385 62 37 2812

Alen Kovac (Fixed income) +385 62 37 1383

Iva Cerovsky (Fixed income) +385 62 37 1716

Davor Spoljar (Equity) +385 62 37 2825

Research, Czech Republic

Head: David Navratil (Fixed income) +420 224 995 439

Petr Bartek (Equity) +420 224 995 227

Jana Krajcova (Fixed income) +420 224 995 232

Radim Kramule (Equity) +420 224 995 213

Martin Lobotka (Fixed income) +420 224 995 192

Lubos Mokras (Fixed income) +420 224 995 456

Jakub Zidon (Equity) +420 224 995 340

Research, Hungary

Head: József Miró (Equity) +361 235-5131

Bernadett Papp (Equity) +361 235-5135

Gergely Gabler (Equity) +361 253-5133

Orsolya Nyeste (Fixed income) +361 373-2830

Research, Poland

Head: Artur Iwanski (Equity) +48 22 330 6253

Magda Jagodzinska (Equity) +48 22 330 6250

Marcelina Hawryluk (Equity) +48 22 330 6255

Tomasz Kasowicz (Equity) +48 22 330 6251

Piotr Lopaciuk (Equity) +48 22 330 6252

Marek Czachor (Equity) +48 22 330 6254

Wiktor Tymochowicz (Equity) +48 22 330 6253

Research, Romania

Head: Lucian Claudiu Anghel +40 21 312 6773

Mihai Caruntu (Equity) +40 21 311 27 54

Treasury - Erste Bank Vienna

Saving Banks & Sales Retail

Head: Thomas Schaufler +43 (0)5 0100 - 84225

Equity Retail Sales

Head: Kurt Gerhold +43 (0)5 0100 - 84232

Fixed Income & Certificate Sales

Head: Thomas Schaufler +43 (0)5 0100 - 84225

Treasury Domestic Sales

Head: Markus Kaller +43 (0)5 0100 - 84239

Corporate Desk

Head: Leopold Sokolicek +43 (0)5 0100 - 84601

Alexandra Blach +43 (0)5 0100 - 84141

Markus Pistracher +43 (0)5 0100 - 84100

Dumitru Dulgheru (Fixed income) +40 21 312 6773 1028

Cristian Mladin (Fixed income) +40 21312 6773 - 1028

Loredana Oancea (Equity) +40 21311 2754

Eugen Sinca (Fixed income) +40 21312 6773 - 1028

Raluca Ungureanu (Equity) +40 21311 2754

Research, Slovakia

Head: Juraj Barta (Fixed income) +421 2 4862 4166

Michal Musak (Fixed income) +421 2 4862 4512

Maria Valachyova (Fixed income) +421 2 4862 4185

Research, Ukraine

Victor Stefanyshyn (Fixed Income) +38 044 593 - 1784

Svitlana Bazilevich (Equity) +38 044 593 - 9286

Maryan Zablotysky (Fixed income) +38 044 593 - 9188

Institutional Sales

Head of Sales Equities & Derivatives

Michal Rizek +44 20 7623 - 4154

Brigitte Zeitberger-Schmid +43 (0)5 0100 - 83123

Equity Sales Vienna XETRA & CEE

Hind Al Jassani +43 (0)5 0100 - 83111

Werner Fuerst +43 (0)5 0100 - 83114

Josef Kerekes +43 (0)5 0100 - 83125

Cormac Lyden +43 (0)5 0100 - 83127

Stefan Raidl +43 (0)5 0100 - 83113

Simone Rentschler +43 (0)5 0100 - 83124

Sales Derivatives

Christian Luig +43 (0)5 0100 - 83181

Manuel Kessler +43 (0)5 0100 - 83182

Sabine Kircher +43 (0)5 0100 - 83161

Christian Klikovich +43 (0)5 0100 - 83162

Armin Pflingstl +43 (0)5 0100 - 83171

Roman Rafeiner +43 (0)5 0100 - 83172

Equity Sales, London

Dieter Benesch +44 20 7623 - 4154

Tatyana Dachyshyn +44 20 7623 - 4154

Declan Wooloughan +44 20 7623 - 4154

Sales, Croatia

Zeljka Kajkut (Equity) +38 562 37 28 11

Damir Eror (Equity) +38 562 37 28 13

Sales, Czech Republic

Michal Brezna (Equity) +420 224 995-523

Ondrej Cech (Fixed income) +420 224 995-577

Michal Rizek +420 224 995-537

Jiri Smehlik (Equity) +420 224 995-510

Pavel Zdichynec (Fixed income) +420 224 995-590

Sales, Hungary

Gregor Glatzer (Equity) +361 235-5144

Krisztián Kandik (Equity) +361 235-5140

Istvan Kovacs (Fixed income) +361 235-5846

Sales, Poland

Head: Andrzej Tabor +4822 330 62 03

Pawel Czuprynski (Equity) +4822 330 62 12

Lukasz Mitan (Equity) +4822 330 62 13

Jacek Krynski (Equity) +4822 330 62 18

Sales, Slovakia

Head: Dusan Svitek +48 62 56 20

Rado Stopiak (Derivatives) +48 62 56 01

Andrea Slesarova (Client sales) +48 62 56 27

Roman Friesacher +43 (0)5 0100 - 84143

Helmut Kirchner +43 (0)5 0100 - 84144

Christian Skopek +43 (0)5 0100 - 84146

Fixed Income Institutional Desk

Head: Thomas Almen +43 (0)5 0100 - 84323

Martina Fux +43 (0)5 0100 - 84113

Fixed Income International & High End Sales Vienna

Jaromir Malak/ Zach Carvell +43 (0)5 100 - 84254

U. Inhofner/ P. Zagan/ C. Mitu +43 (0)5 100 - 84254

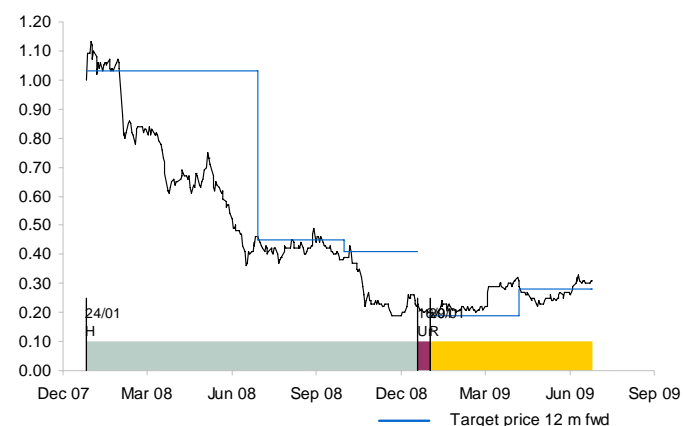
Fixed Income International Sales London

Paul Osment/ Simone Pilz +44 20 7623 4159

Sector Report – Erste Sector Healthcare

Bioton

Rating history



Date	Rating	Price	Target Price
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

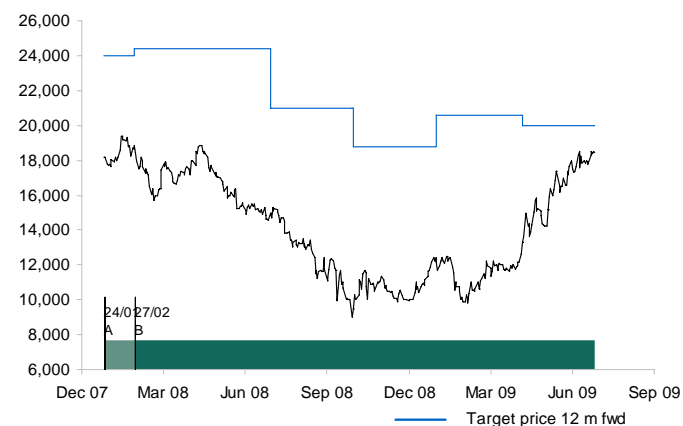
Company

Disclosure

Bioton

Egis

Rating history



Date	Rating	Price	Target Price
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

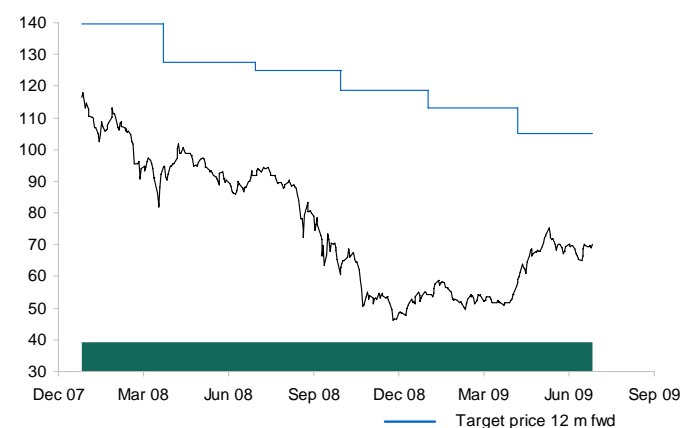
Company

Disclosure

Egis

Krka

Rating history



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

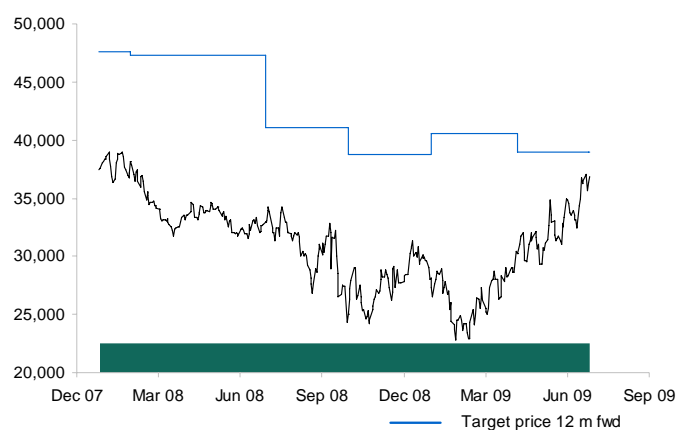
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Disclosure

Krka

Sector Report – Erste Sector Healthcare

Richter Gedeon



Rating history

Date	Rating	Price	Target Price
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

Disclosure

Richter Gedeon

Sector Report – Erste Sector Healthcare

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Erste Group rating definitions

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

Our target prices are established by determining the fair value of stocks, taking into account additional fundamental factors and news of relevance for the stock price (such as M&A activities, major forthcoming share deals, positive/negative share/sector sentiment, news) and refer to 12 months from now. All recommendations are to be understood relative to our current fundamental valuation of the stock. The recommendation does not indicate any relative performance of the stock vs. a regional or sector benchmark.

Distribution of ratings

Recommendation	Coverage universe		Inv. banking-relationship	
	No.	in %	No.	in %
Buy	24	19.2	4	33.3
Accumulate	20	16.0	0	0.0
Hold	43	34.4	5	41.7
Reduce	22	17.6	2	16.7
Sell	8	6.4	0	0.0
N.R./UND.REV./RESTR.	8	6.4	1	8.3
Total	125	100.0	12	100.0

Published by Erste Group Bank AG, Neutorgasse 17, 1010 Vienna, Austria.
Phone +43 (0)5 0100 - ext.

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