Erste Bank Analysts: CEE pharma companies, opportunity for long-term, fundamentally-oriented investors

29.07.2008

CEE pharmas hit hard, despite defensive nature and healthy prospects
Thriving Russia, improving sales mix (and low comparative base) bode well for outlook
Krka and Richter as top picks

Stock markets around the globe continued to tumble over the past weeks, weighed down by fears of a prolonged crisis in the financial sector and slowing global economic growth. Emerging markets, including CEE, were hit hard. In spite of its defensive nature (and still healthy growth prospects), the CEE pharmaceutical sector was not spared. The firming forint along with persistent pricing pressures magnified the slump in Hungary.

Despite rather defensive character, CEE pharma stocks headed south, in line with their home markets. The massive selling wave across the board did not pay any attention to the reported 1Q2008 performance data, nor the (fundamentally unchanged) driving forces set to propel the fortunes of key CEE players, such as the strong y/y rebound of the Russian pharmaceutical market.

“The rising interest rate fever already hit Europe, with the European Central Bank raising its key interest rate to 4.25%. A slowdown in Western European economic growth can be anticipated. Rate hikes are also on the agenda in the CEE countries and bond yields are on the rise. With respect to the rather minimal external indebtedness of CEE companies, the implications for their financial results are minimal. Thus, the main factors to be considered are the applied risk-free rates and changing currency outlooks”, states Vladimira Urbankova, pharma sector analyst at Erste Bank.

While the situation varies from country to country, the weakness of the US dollar seems to last for longer than envisaged. In addition, appreciation of CEE currencies vs. the Euro is more pronounced than originally anticipated, further magnifying the negative currency impact on heavily export-geared pharmaceutical companies, which (e.g. Richter, Krka) recently – in an attempt to minimize the negative effects associated with the US dollar weakness - switched to the Euro as their invoicing currency in the traditionally US dollar denominated Russian market. “The Hungarian forint hit an all-time high vs. the Euro recently, prompting us to adjust our currency forecasts for 2008 and upcoming periods for Richter and Egis. Similarly, the Polish zloty’s strength calls for adjustments to our Bioton model and the record highs of the Czech crown force us to make adequate changes to our Zentiva forecast assumptions”, says Urbankova. “The last (but not least) factor to be taken into consideration is the impact of the healthcare reform package introduced by the Czech government from January 2008 (involving payments for doctor visits, drug prescriptions and hospital stays), as well as the lingering effect of the Hungarian reform measures, putting increasing pricing pressure on the reimbursed drug market segment”, she adds.

While pressure on drug pricing is inevitable, in the medium to long term, CEE pharmaceutical producers (offering affordable generics) should be affected rather marginally, as the ultimate goal is to cover the rising needs for high-quality treatment from the generics medicine pool with possibly higher co-participation of patients in healthcare services, including paying for the drug bill. The latter is painful and, as evidenced by the latest developments, results in an initial slowdown of market growth. However, in the long run, the CEE pharmaceutical markets are set to rise, narrowing the gap in health care (and drug) spending between the CEE region and the EU-15 average.

Vladimira Urbankova: We think that the CEE markets could witness increased volatility in the upcoming reporting season and can not even rule out further downward pressure. On the other hand, for long-term, fundamentally-oriented investors, top CEE pharma companies currently represent a good value at bargain prices. The business outlook is still very promising, supported by a sales pickup in Russia, the key export territory of the CEE pharma players. On top of that, the region’s best companies (particularly Krka) enjoy significant running space in Western markets as well, based on patent expirations and/or efficient niche strategies.

Company	Currency	Current Price (LC)	Year high (LC)	Current price vs YH (%)	Target price (LC)	Upside potential (%)
Krka	EUR	93.8	129.0	-27.7%	125.0	33.9%
Richter Gedeon	HUF	32,595	41,845	-22.1%	41,100	26.1%
Egis	HUF	14,620	23,900	-38.8%	21,010	43.7%
Zentiva	CZK	1,065	1,448	-26.5%	1,155	8.5%
Bioton	PLN	0.43	1.82	-76.4%	0.45	4.7%

Based on closing prices as of July 24, 2008; Source: Erste Group Research

The persisting impact from unfavourable government measures in Hungary, combined with the appreciating forint, will only be partly offset by the reviving Russian market, sending target prices for Richter and Egis down to HUF 41,100 per share and HUF 21,000 per share, respectively. Nevertheless, after the downward move, both companies offer solid upside potential. Consequently, we stick to our Buy recommendations for both Richter and Egis.

Warsaw Stock Exchange-listed Bioton's share price fall was not only due to fundamental reasons; the stock was negatively hit by shattered investor confidence over another failure of the company to deliver on its earlier stated goals. Adjusting our 12-month target price to reflect the worse than anticipated results for the coming period (hampered by the negative impact from the strengthening zloty on the top line, as well as financial results) and incorporating an additional risk-reflecting discount yields a new target price of PLN 0.45 per share (down from PLN 1.03). Given the share price slump, we leave our Hold recommendation unchanged.

The pending takeover story saved Prague-based Zentiva from the big sell-off. PPF's launch of a takeover offer at CZK 950 per share was trumped by Sanofi-Aventis' bid at CZK 1,050. We believe that Zentiva's improving business performance and more news on the possible takeover is set to keep Zentiva in the spotlight. Our revised target price of CZK 1,155 per share suggests that the current price fairly reflects its high growth prospects, but also temporary difficulties in certain markets and uncertainties related to the integration of its Turkish arm. Nevertheless, including a takeover premium comparable to previous transactions in the sector, we would arrive at a target value of around CZK 1,300 per share. Reflecting the vanishing probability of a bidding war after the PPF bid withdrawal, we downgrade the stock to Hold.

Although the 1Q08 results were excellent and the recently published 1H08 sales highlights point to the ongoing strong progress, neither these factors nor its low foreign share ownership saved Krka from the storm on equity markets. We expect that Krka's 1H08 results (due on July 30) will confirm the company's regional competitive edge. Our revised target price of EUR 125.0 per share points to the stock's untapped potential at the currently depressed levels. We confirm Buy recommendation.

ERSTE GROUP

CEE Pharmaceuticals

In search of safe haven - 28 July 2008

Sell-off on equity markets hit CEE pharmas hard, despite their defensive nature and healthy prospects

Richter and Egis' share price woes magnified by negative impact of firming forint

Thriving Russia, improving sales mix (and low comparative base) bode well for outlook

Krka and Richter are our top picks

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Executive summary

- Stock markets around the globe continued to tumble over the past weeks, weighed down by fears of a prolonged crisis in the financial sector and slowing global economic growth. Emerging markets, including CEE, were hit hard. In spite of its defensive nature (and still healthy growth prospects), the CEE pharmaceutical sector was not spared. The firming forint along with persistent pricing pressures magnified the slump in Hungary.

–**The changing situation prompts us to take a new look at our CEE pharma sector universe. While some models do not need a major revision (such as Krka), some require a more thorough analysis, in order to reflect the impact of firming local currencies (namely Richter and Egis, but also Bioton). While the Polpharma acquisition is practically off the table for now, in order to reflect the shifting focus to the consolidated picture of the company, we switch our model to a consolidated one for Richter.**

–**We reviewed our models and set new 12-month target prices for CEE pharma stocks. The persisting impact from unfavorable government measures in Hungary, combined with the appreciating forint, will only be partly offset by the reviving Russian market, sending our target prices for Richter and Egis down to HUF 41,100 per share and HUF 21,000 per share, respectively. Nevertheless, after the downward move, both companies offer solid upside potential. Consequently, we stick to our Buy recommendations for both Richter and Egis.**

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–**The pending takeover story saved Prague-based Zentiva from the big sell-off. PPF's launch of a takeover offer at CZK 950 per share was trumped by Sanofi-Aventis' bid at CZK 1,050. We believe that Zentiva's improving business performance and more news on the possible takeover is set to keep Zentiva in the spotlight. Our revised target price of CZK 1,155 per share suggests that the current price fairly reflects its high growth prospects, but also temporary difficulties in certain markets and uncertainties related to the integration of its Turkish arm. Nevertheless, including a takeover premium comparable to previous transactions in the sector, we would arrive at a target value of around CZK 1,300 per share. Reflecting the vanishing probability of a bidding war after the PPF bid withdrawal, we downgrade the stock to Hold.**

- Although the 1Q08 results were excellent and the recently published 1H08 sales highlights point to the ongoing strong progress, neither these factors nor its low foreign share ownership saved Krka from the storm on equity markets. We expect that Krka's 1H08 results (due on July 30) will confirm the company's regional competitive edge. Our revised target price of EUR 125.0 per share points to the stock's untapped potential at the currently depressed levels. We confirm our Buy recommendation.

- We think that the CEE markets could witness increased volatility in the upcoming reporting season and cannot even rule out further downward pressure. On the other hand, for long-term, fundamentally-oriented investors, top CEE pharma companies currently represent a good value at bargain prices. The business outlook is still very promising, supported by a sales pickup in Russia, the key export territory of the CEE pharma players. On top of that, the region's best companies (particularly Krka) enjoy significant running space in Western markets as well, based on patent expirations and/or efficient niche strategies.

Valuation

Our top picks are Krka and Richter

Zentiva share price to be dictated by takeover bids

All told, a brief look at the revised CEE pharma stock valuations confirms that, after the recent share price slump, the CEE pharma companies offer an excellent opportunity, especially for long-term, fundamentally-oriented investors. After plunging without any important adverse changes in its business or macroeconomic conditions (just the opposite – very sound results - were reported), Krka offers solid upside potential from its current price levels. We believe that Krka represents the best long-term play in the regional pharma sector and, with our newly updated target price arriving at EUR 125.0 per share, we stick to Buy. Both Hungarian companies, Egis and Richter, also saw their share prices retreat too far, in our opinion. Although the negative impact from the pricing pressures linked to the changing drug reimbursement rules and stronger forint will only be partly counterbalanced by the renewed Russian sales dynamism, our new target prices (of HUF 21,000 per share for Egis and HUF 41,100 per share for Richter) point to untapped potential. Furthermore, we believe that, although the Polpharma acquisition would have been accretive for Richter, the damage caused by the transaction failure was not high, as the company has all prerequisites to compensate for the lost opportunity in the long run. Apart from eyeing new acquisition targets in Poland, Richter can further solidify its position in this sizable regional market organically, investing in its local operations in Polfa Grodzisk, where it recently gained full control. The lost deal also significantly reduced the risks seen in the integration of the two companies, including potential (and perhaps underestimated) corporate governance problems after the merger. All told, we leave our recommendations unchanged - Buy for both Egis and Richter, with a bit stronger emphasis on the latter stock. Although Bioton's share price has suffered a lot, we maintain our Hold recommendation. Our new 12-month target price for Bioton is PLN 0.45 per share, down from the earlier PLN 1.03 per share, suggesting that the current price more or less fairly reflects the uncertainties related to the company's outlook, including the impact of the worsening forex situation. Zentiva's share price is poised to continue to neglect business related information, with investors staying tuned to takeover news. The price Sanofi-Aventis is willing to pay at the moment (CZK 1,050 per share) is considered too low to incorporate any takeover premium for a majority position in Zentiva and hence in our opinion it does not represent a ceiling but rather bottom for the stock at the moment.

CEE pharmaceuticals valuation at a glance

24/07/2008	Curr.	Mcap	Price		Recommendation	Performance (EUR terms)			
			Current	Target					
Company		(EURmn)	(LC)			1M	3M	6M	12M
Egis	HUF	489	14,620	21,000	Buy	-2.2%	-9.7%	-11.0%	-34.0%
Intercell	EUR	1,410	29.9	40.5	Buy	-6.4%	11.1%	29.3%	11.4%
A&D Pharma	EUR	77	2.3	under rev.	under rev	-24.6%	-64.6%	-84.4%	-84.7%
Bioton	PLN	400	0.43	0.45	Hold	-19.7%	-29.3%	-55.6%	-70.6%
Krka	EUR	3,322	93.8	125.0	Buy	2.0%	1.5%	-18.8%	-8.4%
Richter Gedeon	HUF	2,612	32,595	41,100	Buy	4.9%	6.3%	-3.9%	-7.5%
Sanochemia	EUR	65	6.4	8.4	Hold	6.5%	-12.5%	-15.9%	-43.5%
Zentiva	CZK	1,712	1,065	1,155	Hold	-4.9%	26.7%	37.6%	-11.6%
Merck KGaA	EUR	14,991	-	-	-	-13.4%	-14.1%	-3.8%	-17.8%
Ranbaxy Laboratories	INR	2,710	-	-	-	-11.6%	-5.0%	13.9%	17.5%
Mylan Inc.	USD	2,549	-	-	-	7.5%	1.2%	-15.5%	-36.0%
Recordati	EUR	983	-	-	-	-4.9%	0.4%	-13.8%	-21.4%
Watson Pharmaceuticals	USD	1,977	-	-	-	7.0%	0.5%	5.5%	-19.2%
Barr Pharmaceuticals Inc	USD	4,558	-	-	-	50.5%	30.0%	19.6%	5.9%
Teva Pharmaceutical	ILS	23,561	-	-	-	1.3%	-1.9%	-4.6%	-8.5%
Stada Arzmeimittel AG	EUR	2,739	-	-	-	2.5%	11.7%	10.4%	-4.5%
EuroStoxx Healthcare	-	122,395	-	-	-	1.3%	-2.7%	-16.3%	-18.4%

CEE pharmaceuticals valuation at a glance (cont.)

	P/E				P/CE				P/BV			
	2006	**2007**	**2008e**	**2009e**	**2006**	**2007**	**2008e**	**2009e**	**2006**	**2007**	**2008e**	**2009e**
Egis	15.0	23.4	10.8	9.5	11.1	12.6	6.7	6.0	2.4	1.7	1.0	0.9
Intercell	-39.1	218.5	175.3	63.1	-41.8	162.3	134.6	56.1	7.3	4.7	4.6	4.3
AD Pharma	23.6	-61.2	nm	n.a.	14.6	-130.1	-18.7	n.a.	1.5	2.1	nm	n.a.
Bioton	57.5	85.4	37.7	21.1	50.2	49.3	17.0	12.4	7.3	2.8	1.4	1.2
Krka	24.9	33.2	19.8	16.3	15.2	20.9	14.5	12.4	4.9	6.6	4.1	3.4
Richter Gedeon	15.8	23.2	15.8	12.3	11.6	14.4	10.2	8.3	2.8	2.5	1.8	1.6
Sanochemia	21.9	neg.	52.2	24.6	9.2	neg.	12.8	9.7	1.0	1.1	1.1	1.0
Zentiva	21.9	26.2	23.2	15.6	15.7	13.2	12.1	9.4	4.4	3.4	3.3	2.8
Median CEE	**21.9**	**26.2**	**23.2**	**16.3**	**13.1**	**14.4**	**12.5**	**9.7**	**3.6**	**2.7**	**1.8**	**1.6**
Merck KGaA	19.6	15.0	12.6	11.3	13.4	13.9	9.9	8.9	4.0	4.9	1.9	1.8
Ranbaxy Laboratories	33.0	21.7	28.1	21.6	35.5	15.4	19.2	15.8	6.1	5.5	5.3	4.5
Mylan Inc.	6.9	9.3	27.9	13.0	6.2	9.1	6.3	5.9	2.2		1.5	1.2
Recordati	13.1	11.5	10.2	9.3	10.0	8.7	7.9	7.5	2.7	2.5	2.2	2.0
Watson Pharmaceuticals	24.2	20.2	15.2	14.1	7.1	8.2	9.8	8.8	1.7	1.6	1.7	1.3
Barr Pharmaceuticals Inc	17.2	19.2	23.6	18.8	15.6	14.2	38.3	19.3		4.5	3.4	2.9
Teva Pharmaceutical	16.6	17.8	17.1	15.4	13.1	19.2	14.7	12.5	2.8	2.6	2.4	2.0
Stada Arzmeimittel AG	26.5	22.2	16.8	14.4	19.6	13.6	11.4	10.2	3.1	3.0	2.7	2.3
Median Peer Group	**18.4**	**18.5**	**17.0**	**14.3**	**13.3**	**13.7**	**10.6**	**9.5**	**2.8**	**3.0**	**2.3**	**2.0**
EuroStoxx Healthcare	22.7	19.2	17.3	15.3	13.7	13.5	12.3	11.8	3.3	2.8	2.6	2.3
CEE to Peer, Prem/Disc	**19%**	**42%**	**37%**	**15%**	**-1%**	**5%**	**17%**	**2%**	**27%**	**-12%**	**-22%**	**-18%**

	EV/Sales				EV/EBITDA				Dividend yield			
	2006	**2007**	**2008e**	**2009e**	**2006**	**2007**	**2008e**	**2009e**	**2006**	**2007**	**2008e**	**2009e**
Egis	2.6	1.8	1.0	0.9	10.7	11.8	6.1	5.1	0.4%	0.5%	0.8%	0.8%
Intercell	25.2	17.3	17.4	9.9	-40.4	272.3	289.1	43.2	0.0%	0.0%	0.0%	0.0%
AD Pharma	1.4	1.3	nm	n.a.	16.6	35.8	nm	n.a.	0.3%	0.0%	0.0%	n.a.
Bioton	26.8	10.3	4.5	3.7	65.2	23.1	11.6	11.1	0.0%	0.0%	0.0%	0.0%
Krka	4.3	5.8	3.6	3.0	14.5	19.0	11.9	10.1	1.0%	0.7%	1.3%	1.6%
Richter Gedeon	3.6	3.2	2.3	1.9	11.1	12.9	8.7	7.1	1.6%	1.1%	1.8%	2.1%
Sanochemia	1.5	1.7	1.6	1.3	7.8	neg.	10.7	7.5	0.0%	0.0%	0.0%	0.0%
Zentiva	3.7	3.2	2.8	2.4	12.4	14.8	11.3	8.9	0.9%	0.8%	0.9%	1.3%
Median CEE	**3.7**	**3.2**	**2.8**	**2.4**	**11.8**	**19.0**	**11.3**	**8.9**	**0.3%**	**0.3%**	**0.4%**	**0.8%**
Merck KGaA	2.3	2.4	2.0	1.7	9.9	9.1	6.7	5.7	1.3%	1.5%	1.7%	1.9%
Ranbaxy Laboratories	3.0	2.9	2.7	2.3	20.9	21.3	17.5	14.3	2.0%	2.0%	2.1%	2.1%
Mylan Inc.	2.9	3.3	1.7	1.4	9.1	11.6	8.1	5.9	2.1%	1.4%	0.5%	0.0%
Recordati	2.0	2.2	1.5	1.4	8.1	8.7	6.0	5.4	3.9%	4.6%	5.0%	5.4%
Watson Pharmaceuticals	1.9	1.4	1.4	1.2	9.4	6.7	6.6	6.0	0.0%	0.0%	0.0%	0.0%
Barr Pharmaceuticals Inc	3.6	4.8	3.2	2.8	8.5	13.7	12.1	9.8	0.0%	0.0%	0.0%	0.0%
Teva Pharmaceutical	3.3	4.2	3.5	3.0	10.2	13.7	12.2	10.5	0.7%	0.8%	1.0%	0.9%
Stada Arzmeimittel AG	2.5	2.2	2.1	1.9	12.7	10.9	10.2	9.2	1.3%	1.5%	1.9%	2.2%
Median Peer Group	**2.7**	**2.7**	**2.0**	**1.8**	**9.7**	**11.2**	**9.2**	**7.6**	**1.3%**	**1.5%**	**1.3%**	**1.4%**
EuroStoxx Healthcare	3.3	2.7	2.1	2.0	12.7	10.9	10.2	9.2	1.3%	1.5%	1.7%	2.1%
CEE to Peer, Prem/Disc	**36%**	**20%**	**37%**	**33%**	**22%**	**69%**	**24%**	**17%**	**-75%**	**-82%**	**-69%**	**-41%**

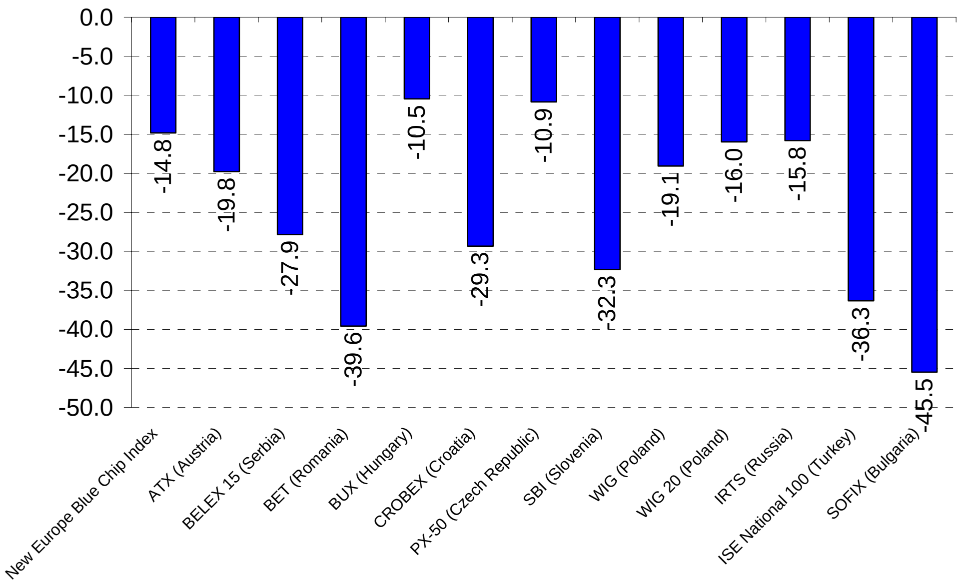
Source: JCF, Erste Group Research, based on closing prices as of July 24, 2008

Market overview

Financial sector worries kicked off by US mortgage crisis sparked global equity market sell-off wave

The most recent sell-off on equity markets was sparked by global economic woes. The rising interest rates reduced the attraction of investments in stocks and pointed to the danger of slowing economic growth as well. Contrary to the similar large selling wave in 1997-98, but similarly to the sell-off in 2006, the market turmoil did not originate in emerging/converging countries - in fact, it was the US mortgage banks' troubles that initiated the equity markets' tumble. Nevertheless, despite the fact that most CEE economies are in a relatively stable condition, CEE equity markets have suffered a lot, as risk aversion is on the rise and the emerging equity market funds saw a sharp turnaround in flows, recording huge outflows. As a result, CEE markets not only retreated from the year-earlier highs, erasing most of the gains posted last year; they have sunk deeper and deeper into negative territory since the beginning of the year. CEE pharma stocks were no exception.

CEE indices have headed south since beginning of year (%)



Source: JCF, Erste Group Research, based on closing prices as of July 24, 2008

CEE pharmas shared fate of their home markets

Pending takeover story kept Zentiva's share price aloft

Despite their rather defensive character, CEE pharma stocks headed south, in line with their home markets. The massive selling wave across the board did not pay any attention to the reported 1Q2008 performance data, nor the (fundamentally unchanged) driving forces set to propel the fortunes of key CEE players, such as the strong y/y rebound of the Russian pharmaceutical market. Moreover, due to the lingering impact of tightening drug reimbursement rules introduced by the government at the beginning of 2007, as well as their relatively high export exposure (with results dampened by the firming forint), Hungarian pharmaceutical stocks Richter and Egis underperformed their local market. However, even the stocks with untouched fundamentals and excellent business performance (like Krka) were dragged down by negative sentiment, falling significantly from their earlier highs. The still relatively low foreign shareholder ownership of the company (just 4.6% of the total at the end of March 2008, vs. 62% in the case of Richter) did not help this time. The best performer in these turbulent times was Zentiva, supported firmly by its nascent takeover story.

After slump, CEE pharmas offer running space

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Taking new look at CEE pharma universe...

...reviewing our models to reflect changing interest rates, currency situation...

The changing situation on equity markets calls for a second look at our valuation models. The rising interest rate fever already hit Europe, with the European Central Bank raising its key interest rate to 4.25%. A slowdown in Western European economic growth can be anticipated. Rate hikes are also on the agenda in the CEE countries and bond yields are on the rise. With respect to the rather minimal external indebtedness of CEE companies, the implications for their financial results are minimal. Thus, the main factors to be considered are the applied risk-free rates and changing currency outlooks. While the situation varies from country to country, the weakness of the US dollar seems to last for longer than envisaged. In addition, appreciation of CEE currencies vs. the euro is more pronounced than originally anticipated, further magnifying the negative currency impact on heavily export-geared pharmaceutical companies, which (e.g. Richter, Krka) recently – in an attempt to minimize the negative effects associated with the US dollar weakness - switched to the euro as their invoicing currency in the traditionally US dollar-denominated Russian market. Importantly, the Hungarian forint hit an all-time high vs. the euro recently, prompting us to adjust our currency forecasts for 2008 and upcoming periods for Richter and Egis. Similarly, the Polish zloty's strength calls for adjustments to our Bioton model and the record highs of the Czech crown force us to make adequate changes to our Zentiva forecast assumptions.

...as well as impact of ongoing healthcare reform programs in Czech and Hungarian markets

The last (but not least) factor to be taken into consideration is the impact of the healthcare reform package introduced by the Czech government from January 2008 (involving payments for doctor visits, drug prescriptions and hospital stays), as well as the lingering effect of the Hungarian reform measures, putting increasing pricing pressure on the reimbursed drug market segment. After publishing their 1Q08 reports, both Richter and Egis provided relatively detailed guidance regarding the envisaged changes to their 2008 outlook, allowing us to make adequate adjustments to our forecasts. Here we want to emphasize that, while pressure on drug pricing is inevitable, in the medium to long term, CEE pharmaceutical producers (offering affordable generics) should be affected rather marginally, as the ultimate goal is to cover the rising needs for high-quality treatment from the generics medicine pool with possibly higher co-participation of patients in healthcare services, including paying for the drug bill. The latter is painful and, as evidenced by the latest developments, results in an initial slowdown of market growth. However, in the long run, the CEE pharmaceutical markets are set to rise, narrowing the gap in health care (and drug) spending between the CEE region and the EU-15 average.

2Q2008 results preview

1H2008 results anticipated to be solid; bolstering effect of strong y/y Russian revival…

The second quarter reporting season is approaching, to be kicked off by Krka, which is scheduled to announce its 1H2008 report on July 30, followed by Zentiva on August 4. In fact, Krka informed investors about its 1H08 sales highlights on July 3 and Zentiva made a similar move on July 22. Consolidated sales growth of some 20% y/y (to EUR 469.3mn), driven by sound performance in key markets (sales in CEE markets up by 22% y/y, Russia/CIS by 17% y/y and Western markets by 46% y/y), indicates that Krka will keep its position as the regional leader and created high expectations for the company's overall business performance, including profitability parameters. We project Krka's net income rising 18.8% y/y to EUR 80.8mn in 1H2008. Zentiva's 1H08 sales report provided another evidence of the buoying effect from the integration of the Turkish business. According to management estimates Zentiva's 1H08 sales are envisaged to amount to CZK 8.9bn, including some CZK 2.6bn from Turkey. We anticipate integration of the low-margin Turkish operations to be only partly offset by cost saving efforts in the area of sales and marketing expenses, weighing on Zentiva's profitability margins.

…to be partly compromised by negative effect from local currencies' appreciation

Nevertheless, given the very low comparative base (with 2Q07 hampered by the Romanian operation's write-offs and provisioning), we forecast Zentiva's net income up 27.8% y/y to CZK 399.2mn in 2Q2008. Although the low comparative base theoretically speaks in favor of a solid tempo for both Hungarian companies, we expect the firming forint to take a toll on both the top and bottom line in the 2Q08 period. While we anticipate Egis posting 55.5% y/y net profit growth (to HUF 8,055mn) in 1-3Q2008, on sales of HUF 71,804mn (up by 3.4% y/y), in the third quarter alone, we envisage Egis' sales retreating by 5.0% y/y and a minor drop is expected on the bottom line (by 6.3% y/y to HUF 2,210mn). We expect Richter to post net profit of HUF 16,915mn, on sales of HUF 86,711mn (unconsolidated) in 1H2008; the second quarter is envisaged to bring a flat top line (HUF 43,452mn) and a y/y slump to HUF 6,732mn on the bottom line. With sales enjoying a boost from consolidating the Romanian wholesale operations this year, as well as somewhat lesser damage from the firming forint on the consolidated financial result, we project a consolidated sales rise of 4.9% y/y and a flat bottom line in 1H2008. Finally, despite the boosting effect from the first-time consolidation of Marvel and two Italian companies, in the absence of one-offs (and hampered by the appreciating zloty), Bioton is expected to see its bottom line plummet y/y to a loss of PLN 2.5mn in 2Q2008.

Company Report – Pharmaceuticals – Poland – July 28, 2008

Bioton Hold

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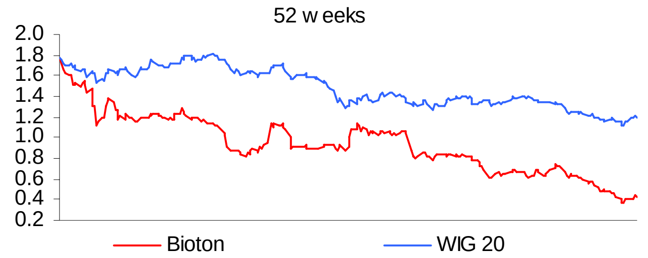
PLN mn	2007	2008e	2009e	2010e
Net sales	270.9	375.3	454.4	590.6
EBITDA	120.9	145.4	149.8	185.4
EBIT	100.2	103.8	106.0	139.2
Net result after min.	28.2	34.1	62.3	104.3
EPS (PLN)	0.0	0.0	0.0	0.0
CEPS (PLN)	0.0	0.0	0.0	0.0
BVPS (PLN)	0.3	0.3	0.3	0.4
Div./share (PLN)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	23.1	11.6	11.1	8.9
P/E (x)	85.4	37.7	21.1	12.6
P/CE (x)	49.3	17.0	12.4	8.7
Dividend Yield	0.0%	0.0%	0.0%	3.5%



Performance	12M	6M	3M	1M
in PLN	-75.7%	-57.0%	-31.7%	-23.2%
in EUR	-71.6%	-51.8%	-27.7%	-19.9%

Share price (PLN)	0.43	Reuters	BOTN.WA	Free float	43.3%
Number of shares (mn)	3,059.8	Bloomberg	BIO PV	Shareholders	Prokom Investment (33.3%)
Market capitalization (PLN mn / EUR mn)	1,316 / 408	Div. Ex-date			Polaris Finance (10%)
Enterprise value (PLN mn / EUR mn)	2,800 / 779	**Target price**	**0.45**	Homepage:	www.bioton.p

Hurt by strong zloty, rising risk aversion

- **We continue to believe that full exploitation of BioPartners and SciGen's strong biotech portfolio and the shoring up of capacities in the core insulin business in key markets should propel Bioton's long-term fortunes. Nevertheless, the road is bumpy and the company's results are well behind the company's originally stated targets, resulting in shattered investor confidence. This and the increasing risk aversion among investors towards stocks with lower predictability of earnings and relatively smaller market caps prompt us to apply an additional 10% discount to our DCF-derived target price. All told, we arrive at a 12-month target price of around PLN 0.45 per share (down from the earlier target of PLN 1.03), suggesting that the current Bioton share price more or less adequately balances its growth potential and risks. Consequently, we stick to Hold.**

- **We incorporated into our model 1) the lingering negative impact from the persistently weak US dollar, both on the top line and the company's financial result; 2) higher than earlier anticipated losses linked to the HTL Strefa stake revaluation; 3) lower underlying profitability, but also the positive effect from milestone payments linked to the BioPartners acquisition; 4) adjustments to our DCF model, namely raising risk-free rate assumptions and an additional 10% discount to the target price to reflect the increasingly risk-averse equity market environment. All this sends our new sales target for 2008 to PLN 375.3mn and net profit forecast to just PLN 34.1mn, down 29% and 61%, respectively, compared to our previous expectations.**

- **We anticipate the 2Q2008 results to further demonstrate the negative impact from the weakening US dollar. We forecast Bioton's sales to advance by about 42% y/y to PLN 75.7mn in 2Q2008, as the beneficial impact from the first-time consolidation of Marvel and the two Italian companies will be partly compromised by the negative effect of the weakening US dollar on its exports. Given the unfavorable forex developments, the 2Q financial result is set to remain deeply in red territory and continue to weigh on the company's bottom line. Consequently, we envisage Bioton posting a net loss of PLN 2.5mn in 2Q2008, resulting in a sizable 97% y/y drop in the company's 1H2008 net profit (to PLN 2.2mn).**

Changes in forecast/outlook

Top line tempo less prominent than originally envisaged; weak US dollar continues to hurt...

While the q/q performance remains uneven (with the acquisition-associated one-off items significantly distorting the picture), the steep appreciation of the Polish zloty and opposite trend for the US dollar are continuing to take a toll on Bioton's results. Although the company still has all prerequisites to catch up in the remainder of 2008, the tempo will undoubtedly be somewhat more subdued than originally thought. The company's management scaled back its guidance, now envisaging sales of around PLN 400mn for 2008 (down from the earlier targeted PLN 500mn). Due to the postponements in completion of the transaction, consolidating the two Italian companies (Pharmatex Italia and Fisiopharma) started only from 2Q2008. Moreover, Bioton (unlike its peers) still invoices its sales in Russia in US dollars, an additional drain on the company's top line. Going forward, we continue to envisage that Bioton's insulin sales in Russia will represent an important and expanding part of its business, especially after completion of its investment in a new manufacturing facility in the Orel region. Nevertheless, reflecting the latest company guidance, we trim our forecasts here and envisage Bioton's sales in Russia at some USD 20mn (down from the USD 40mn projected earlier) in 2008. With respect to the US dollar weakening, this translates into PLN 44mn, well below the earlier estimated PLN 116mn. In total, we envisage Bioton's insulin sales to amount to PLN 152.3mn, out of which the domestic market is anticipated to deliver PLN 68.8mn. Although the latest news flow evidences the ongoing interest of Bioton on this issue, we stick to our earlier assumptions on the LFO sales contribution. Incorporating the above-mentioned negative influences, we are prompted to trim our sales target from PLN 528.7mn to PLN 375.3mn for 2008, corresponding to a 38.5% y/y rise.

we reduce our 2008 sales target to PLN 375.3mn …

… our 2008 EBIT target to PLN 103.8mn

Bioton's profitability margins continue to be largely influenced by irregular one-off income, with the underlying business profitability showing room for improvement. Given the estimated PLN 70mn contribution from milestone payments (recorded as part of revenues), we lift our 2008 gross margin target from 58.7% to 61.4%. While we leave our administrative and general costs, as well as sales and marketing expenditures as a percentage of actual sales broadly unchanged in relative terms, this pushes up our new 2008 operating profit margin target to 27.7% (up from the 23.0% projected earlier). Our new operating profit target arrives at PLN 103.8mn (down from the PLN 121.5mn projected earlier).

Changes to 2008 and 2009 forecasts

PLN mn	2008 orig. forecast		2008 new forecast		2009 orig. forecast		2009 new forecast	
Net sales	**528.7**	**100.0%**	**375.3**	**100.0%**	**660.3**	**100.0%**	**454.4**	**100.0%**
Costs of good sold	218.1	41.3%	144.9	38.6%	264.4	40.1%	182.0	40.1%
Gross profit	**310.5**	**58.7%**	**230.5**	**61.4%**	**395.8**	**59.9%**	**272.3**	**59.9%**
Sales & marketing expenses	118.9	22.5%	76.9	20.5%	150.9	22.9%	103.8	22.9%
General & admin.expenses	81.9	15.5%	58.2	15.5%	96.7	14.6%	69.3	15.3%
Other operating income	21.1	4.0%	15.0	4.0%	23.1	3.5%	15.9	3.5%
Other operating expenses	9.3	1.8%	6.6	1.8%	13.2	2.0%	9.1	2.0%
EBIT	**121.5**	**23.0%**	**103.8**	**27.7%**	**158.1**	**23.9%**	**106.0**	**23.3%**
Financial result	-16.3	-3.1%	-64.7	-17.2%	-14.7	-2.2%	-32.7	-7.2%
Pre-tax profit	105.3	19.9%	39.1	10.4%	143.5	21.7%	73.3	16.1%
Income taxes	20.0	3.8%	7.4	2.0%	27.3	4.1%	13.9	3.1%
Minority interest	2.1	0.4%	2.5	0.7%	2.5	0.4%	3.0	0.7%
Net income after min. interest	**87.3**	**16.5%**	**34.1**	**9.1%**	**118.7**	**18.0%**	**62.3**	**13.7%**

Source: Erste Group Research

…and our bottom line target to PLN 34.1mn for 2008, down from earlier projected PLN 87.3mn

The company's financial result in the first quarter of 2008 was weighed down by forex losses and the revaluation of its financial investment in HTL-Strefa to a loss of PLN 32.3mn (for comparison the full 2007 financial loss amounted to PLN 85.2mn). Although this part of the expenses remains difficult to predict (in particular, HTL Strefa revaluation related losses), the worse than expected 1Q performance and persistently weakening US dollar vs. the appreciating zloty prompt us to make a significant cut in our 2008 forecast. We now envisage the financial result staying in red territory at around a PLN 64.7mn loss (vs. the earlier projected PLN 16.3mn financial loss). We stick to our effective tax rate assumption for 2008 of 19% for the time being and arrive at a net profit target of PLN 34.1mn, down from the PLN 87.3mn projected earlier.

2Q2008 results preview

Bioton is scheduled to report its 2Q2008 results on August 14, 2008. We expect the company to post a 2Q2008 net loss of PLN 2.5mn, on sales of PLN 75.7mn (consolidated and according to IFRS standards), translating into 1H2008 net profit of PLN 2.2mn on sales of PLN 166.4mn.

2Q2008 results preview

IFRS consolidated	2Q2008e	2Q 2007	y/y	1H2008e	1H2007	y/y
Total sales (PLN 000)	75,717	53,339	*42.0%*	166,446	112,664	*47.7%*
Operating profit (PLN 000)	11,583	77,806	*-85.1%*	50,432	87,696	*-42.5%*
Net income (PLN 000)	-2,542	56,497	*-104.5%*	2,202	65,732	*-96.6%*
Operating margin	*15.3%*	*145.9%*		*30.3%*	*77.8%*	
Net margin	*-3.4%*	*105.9%*		*1.3%*	*58.3%*	

Source: Erste Group Research, Company data

We forecast Bioton's sales advancing by about 42% y/y to PLN 75.7mn in 2Q2008, as the beneficial impact from the first-time consolidation of Marvel and the two Italian companies will be partly compromised by the negative effect of the weakening US dollar on its insulin exports (particularly to Russia). Furthermore, in the absence of a milestone payment boost, Bioton's operating profitability margin is anticipated to retreat from its exceptionally high 1Q level to 15.3% in 2Q, translating into a 1H2008 EBIT margin of 30.3%. (Accounting for negative goodwill linked to the BioPartners acquisition added some PLN 77.7mn to 2Q2007 EBIT.) Revaluation losses linked to the HTL Strefa stake are set to diminish in 2Q, with the resulting 1H2008 loss amounting to some PLN 2mn. Nevertheless, given the unfavorable forex developments (the strengthening of the Polish zloty vs. the weakening US dollar), the 2Q financial result is set to remain deeply in red territory and continue to drag down the company's bottom line. Consequently, we forecast the company posting a net loss of PLN 2.5mn in 2Q2008, resulting in a sizable 97% y/y drop in the company's 1H2008 net profit to PLN 2.2mn.

12-month target price of PLN 0.45 indicates that Bioton's current price fairly balances its prospects with its current risks

We stick to Hold

Incorporating all of the above-mentioned adjustments into our projections and fine-tuning some other parameters of our DCF model (e.g. increasing the risk-free rate from 5.7% to 6.3%), we arrive at a 12-month target price of PLN 0.5 per share, down from the earlier PLN 1.03 per share. (Here it is worth mentioning that the capital increase took place on December 21, 2007 and was registered by the court on January 4, 2008. With respect to that, we opt to use adjusted net debt position, i.e. including the proceeds raised from the capital increase, in our DCF model, along with the new fully diluted number of shares.) The persisting global equity market woes, corporate deal postponements and increasing risk aversion (particularly hitting smaller stocks with less predictable earnings developments) sent Bioton's share price nose-diving and increased the volatility of the stock enormously in the past period. While we believe that Bioton's story maintains its biotech flavor and the company's edge in the insulin product niche should show its benefits in the long run, it might still take some time before investors regain their appetite for the stock. Reflecting all of the above-mentioned worries related to risks associated with investment in the stock, we opt to incorporate an additional 10% discount to our fundamentally-based DCF-derived target price. Although there might be interesting entry levels in the meantime (given the stock's volatility) for less risk-averse investors, with a new 12-month target price of PLN 0.45 per share, we stick to our Hold recommendation on the company.

DCF valuation

Free cash flow forecast

PLN 000	2008e	2009e	2010e	2011e	2012e
EBIT	103,787	106,023	139,158	179,862	220,487
Depreciation	41,660	43,758	46,238	48,818	51,298
EBITDA	145,447	149,781	185,396	228,680	271,785
Investments	-277,345	-49,027	-52,068	-52,109	-52,151
Change in working capital	-44,492	-31,953	-42,835	-44,575	-49,202
Corporate income taxes	7,424	13,926	23,641	31,586	41,726
Free cash flow	-183,815	54,875	66,852	100,410	128,706

	08-12e	**perpetuity**		
			PV of the FCF (PLN mn)	86.3
beta	0.84	1.0	PV of TV (PLN mn)	1,328.5
risk free rate (%)	6.3%	5.0%	Total value of the company (PLN mn)	1,414.8
market premium (%)	5.0%	5.0%	-net debt (PLN mn)	121.9
WACC (%)	9.7%	9.6%	Value of the equity (PLNmn)	1,292.9
perpetuity cash flow growth rate (%)		3.5%	Equity value per share (PLN) as of 31.12. 2007	0.42
			Equity value per share (PLN) as of 31.7. 2009	0.50

Equity value per share (PLN) as of 31.7. 2009

		Discount rate				
		8.75%	9.25%	9.75%	10.25%	10.75%
Perpetuity cash flow growth rate	2.5%	0.52	0.47	0.42	0.38	0.35
	3.0%	0.56	0.50	0.45	0.41	0.37
	3.5%	0.62	0.55	0.49	0.44	0.40
	4.0%	0.68	0.60	0.53	0.48	0.43
	4.5%	0.77	0.67	0.59	0.52	0.47

Source: Erste Group Research

Income Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, PLN mn, 31/12)	31/12/2005	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Net sales	**151.59**	**215.48**	**270.94**	**375.35**	**454.35**	**590.65**
Cost of goods sold	-70.40	-81.64	-122.93	-144.88	-182.04	-235.02
Gross profit	**81.19**	**133.84**	**148.01**	**230.47**	**272.32**	**355.63**
SG&A	-54.55	-85.47	-110.20	-135.13	-173.11	-225.33
Other operating revenues	19.21	47.16	82.39	15.01	15.90	20.67
Other operating expenses	-4.13	-20.67	-19.98	-6.57	-9.09	-11.81
EBITDA	**51.00**	**88.54**	**120.95**	**145.45**	**149.78**	**185.40**
Depreciation/amortization	-9.28	-13.68	-20.72	-41.66	-43.76	-46.24
EBIT	**41.72**	**74.86**	**100.23**	**103.79**	**106.02**	**139.16**
Financial result	-1.96	32.03	-85.24	-64.71	-32.73	-14.73
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**39.76**	**106.88**	**14.99**	**39.08**	**73.30**	**124.43**
Income taxes	-5.13	-14.19	11.59	-7.42	-13.93	-23.64
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	0.00	1.07	1.65	2.47	2.96	3.56
Net result after minorities	**34.63**	**93.77**	**28.22**	**34.12**	**62.33**	**104.34**

Balance Sheet	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, PLN mn, 31/12)						
Intangible assets	51.69	395.91	672.41	628.50	608.84	589.10
Tangible assets	96.87	169.23	268.62	329.87	357.81	386.41
Financial assets	50.39	65.01	209.65	227.16	247.48	270.41
Total fixed assets	**198.95**	**630.14**	**1,150.68**	**1,185.53**	**1,214.14**	**1,245.93**
Inventories	41.89	61.99	99.63	115.25	136.02	165.33
Receivables and other current assets	103.35	229.77	248.76	324.73	381.80	460.44
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	13.93	66.76	47.08	67.69	104.22	126.56
Total current assets	**159.17**	**358.53**	**395.48**	**507.68**	**622.04**	**752.33**
TOTAL ASSETS	**358.12**	**988.67**	**1,546.15**	**1,693.21**	**1,836.18**	**1,998.25**
Shareholders'equity	**255.42**	**787.61**	**872.36**	**967.56**	**1,059.17**	**1,132.59**
Minorities	**0.00**	**17.53**	**14.44**	**16.16**	**16.16**	**16.16**
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	0.04	7.62	163.87	167.96	172.16	176.47
Other LT liabilities	20.75	60.58	96.83	101.67	106.76	112.10
Total long-term liabilities	**20.79**	**68.20**	**260.70**	**269.64**	**278.92**	**288.56**
Interest-bearing ST debts	43.13	54.33	246.06	258.36	262.24	275.35
Other ST liabilities	38.79	61.00	152.60	181.49	219.69	285.59
Total short-term liabilities	**81.92**	**115.33**	**398.66**	**439.85**	**481.93**	**560.94**
TOTAL LIAB. , EQUITY	**358.12**	**988.67**	**1,546.15**	**1,693.21**	**1,836.18**	**1,998.25**

Cash Flow Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	7.13	-7.92	-0.53	40.62	77.48	101.90
Cash flow from investing activities	-70.51	-392.27	-320.57	-277.35	-49.03	-52.07
Cash flow from financing activities	47.20	454.67	301.42	257.33	8.07	-27.50
CHANGE IN CASH , CASH EQU.	**-16.19**	**54.48**	**-19.68**	**20.61**	**36.53**	**22.34**

Margins & Ratios	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Sales growth	nm	42.1%	25.7%	38.5%	21.0%	30.0%
EBITDA margin	33.6%	41.1%	44.6%	38.7%	33.0%	31.4%
EBIT margin	27.5%	34.7%	37.0%	27.7%	23.3%	23.6%
Net profit margin	22.8%	43.0%	9.8%	8.4%	13.1%	17.1%
ROE	27.1%	18.0%	3.4%	3.7%	6.2%	9.5%
ROCE	23.2%	15.5%	3.1%	2.5%	4.1%	6.5%
Equity ratio	71.3%	81.4%	57.4%	58.1%	58.6%	57.5%
Net debt	29.2	-4.8	362.8	358.6	330.2	325.3
Working capital	77.3	243.2	-3.2	67.8	140.1	191.4
Capital employed	305.4	860.9	1,346.5	1,444.0	1,512.3	1,586.1
Inventory turnover	3.4	1.6	1.5	1.3	1.4	1.6

Source: Company data, Erste Group estimates

Company Report – Pharmaceuticals – Hungary – July 28, 2008

Egis Buy

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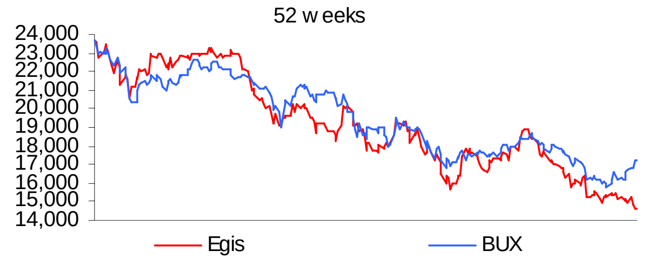
HUF mn	2007	2008e	2009e	2010e
Net sales	92,489.0	96,127.8	105,350.7	123,972.4
EBITDA	14,265.0	16,071.3	18,599.6	22,325.2
EBIT	8,063.0	9,599.1	11,617.3	14,706.3
Net result after min.	7,664.0	10,524.8	11,959.7	14,779.0
EPS (HUF)	984.4	1,351.8	1,536.1	1,898.2
CEPS (HUF)	1,830.3	2,179.8	2,429.7	2,873.6
BVPS (HUF)	13,150.8	14,382.6	15,798.8	17,577.0
Div./share (HUF)	120.0	120.0	120.0	120.0
EV/EBITDA (x)	11.8	6.1	5.1	4.0
P/E (x)	23.4	10.8	9.5	7.7
P/CE (x)	12.6	6.7	6.0	5.1
Dividend Yield	0.5%	0.8%	0.8%	0.8%



Performance	12M	6M	3M	1M
in HUF	-38.2%	-19.4%	-16.4%	-4.8%
in EUR	-34.4%	-10.8%	-9.2%	-2.1%

Share price (HUF)	14620.00	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)	113,827 / 490	Div. Ex-date	29/04/08		
Enterprise value (HUF mn / EUR mn)	168,216 / 670	**Target price**	**21,000.0**	Homepage:	www.egis.hu

Domestic market slowdown more than fully priced

- **Our revised DCF-derived 12-month target arrives at HUF 21,000 per share, below our earlier target of HUF 24,400. A brief look at the current price levels reassures us that the sell-off has been overdone and that Egis' currently depressed share price fails to reflect the company's improving fortunes in key export markets, as well as strong management commitment to enhance profitability parameters. Buy maintained.**

- **We have incorporated into our model 1) the negative impact from the slowdown of the Hungarian pharma market (per the company's guidance), but at the same time somewhat stronger than earlier anticipated sales tempo in CEE markets; 2) the bold cost cutting initiatives of the company, which are especially visible in the area of sales and marketing costs; 3) the revised HUF/USD average exchange rates for 2008 and the coming years, with the appreciating HUF negatively affecting Egis and 4) adjustments to the parameters of our DCF model, in particular raising the risk-free rate assumptions. While all of this sent our new net profit target for 2007/08 down 11.1% compared to our previous forecast, given the low comparative base, the growth on the bottom line is expected at an impressive 37.3% y/y for this fiscal year.**

- **Egis' 3Q2007/08 results are expected to demonstrate the sluggishness of the company's home market (sales envisaged to fall by some 9.5% y/y), to be partly compensated for by still buoyant exports, in particular to the CEE region (up by 44% y/y). In total, we project the company posting 3Q sales of HUF 23,071mn, down 5% y/y. We continue to envisage Egis' profitability to be under pressure from domestic price cuts, as well as from the expanding share of bulk chemicals, all of which should keep the EBIT margin below the 10% mark in 3Q. Nevertheless, reflecting the cost cutting initiatives, we forecast EBIT up 8% y/y in 3Q2007/08. The negative impact from forex developments on receivables reassessment is foreseen to send net profit down 6.3% y/y to HUF 2,210mn in 3Q.**

Changes in forecast / outlook

Domestic market outlook still not rosy, but expanding exports should provide efficient antidote

The home market situation is slightly worse than originally anticipated. In 2Q2007/08, Egis' sales fell by 14.2% y/y, reflecting both several rounds of price cuts coming after April 1, 2007, as well as the deteriorating market position of certain products (most importantly *Coverex,* which is facing increasing generic competition pressure). Consequently, CFO Laszlo Marosffy has also become somewhat less optimistic regarding the 2007/08 sales, which are currently seen down some 8% to 10% y/y (vs. the previous guidance of a drop of 1% to 5% y/y). Nevertheless, the market is seen to be bottoming out this year and, according to Marosffy, an optimistic scenario for 2009 would still calculate with a minor (around 3-4%) y/y sales growth in value terms in the domestic market. Consequently, we trim our 2007/08 domestic sales target to HUF 29.1bn, corresponding to a 9% y/y drop (down from the previous forecast of HUF 30.8bn, assuming a 3.5% y/y decline). We also slightly reduce our 2008/09 projected domestic sales target to HUF 29.9bn, corresponding to a 3% y/y rise.

Russia/CIS: Sales within the DLO program in Russia reached just USD 0.6mn in 2Q2007/08, similarly to the previous quarter. Thanks to the private market, Egis' sales in Russia nevertheless rose by 44% y/y to USD 29.2mn in 2Q2007/08, above the market and our expectations. Nevertheless, we remain on the conservative side and continue to envisage Egis' sales tempo both in Russia alone and in Russia/CIS to be around 15% y/y in 2007/08 (all in USD terms).

CEE markets: Reflecting the company's upwardly revised guidance (as well as the persistent weakening of the US dollar), we raise the targeted growth to 31% y/y (from the earlier 29% y/y) in USD terms in Central and Eastern European markets in 2007/08. Moreover, we envisage Egis' sales tempo remaining at this relatively high (i.e. 12-15% y/y in euro terms) level in the next three years, lifting our projections correspondingly.

Western markets: Sales of finished products are likely to exceed the original flat sales target and show some rise in 2007/08, as growth remains strong both in Egis' traditional portfolio, as well as in contractual business; in US currency terms, it is supported also by the weaker US dollar vs. euro. All told, we increase our 2007/08 forecast here, from USD 24mn to USD 28.8mn. Sales of bulk chemicals (fueled by API supplies for Servier) are still developing dynamically; we assume 43.5% y/y growth (to around USD 75mn) in 2007/08 in this category. However, based on indicative orders from Servier for the next year, 2007/08 should represent a peak (based on stock buildup and high initial deliveries for Servier product launches), followed by a (currently estimated) 20% y/y decline in 2008/09 (all in USD terms). Finally, we factor in a newly revised currency forecast (annual average exchange rate of HUF 161.8 / USD for 2008 (from HUF 182.4/USD) and HUF 175.0/USD for 2009 (from HUF 196.2/USD). After incorporating all the above mentioned changes into our sales projections, our 2007/08 sales target arrives at HUF 96,128mn. For 2008/09, our new sales target is HUF 105,351mn, vs. the previous forecast of HUF 119,919mn.

Summary of changes to 2007/08 and 2008/09 forecasts

(HUF 'mn)	07/08 orig. forecast		07/08 new forecast		08/09 orig. forecast		08/09 new forecast	
Net sales	**103,648**	**100.0%**	**96,128**	**100.0%**	**119,919**	**100.0%**	**105,351**	**100.0%**
Cost of sales	45,661	44.1%	42,262	44.0%	52,327	43.6%	45,738	43.4%
Gross profit	**57,987**	**55.9%**	**53,866**	**56.0%**	**67,592**	**56.4%**	**59,613**	**56.6%**
Marketing & distr.costs	23,879	23.0%	22,243	23.1%	27,706	23.1%	24,304	23.1%
Administration costs	11,555	11.1%	10,977	11.4%	13,168	11.0%	11,850	11.2%
R & D costs	8,246	8.0%	7,715	8.0%	9,540	8.0%	8,455	8.0%
Other operating exp.	4,249	4.1%	3,901	4.1%	4,432	3.7%	3,959	3.8%
Other oper. income	570	0.5%	570	0.6%	573	0.5%	573	0.5%
Operating profit	**10,628**	**10.3%**	**9,599**	**10.0%**	**13,319**	**11.1%**	**11,617**	**11.0%**
Financial result	2,138	2.1%	1,659	1.7%	1,255	1.0%	1,290	1.2%
Pre-tax profit	**12,766**	**12.3%**	**11,258**	**11.7%**	**14,574**	**12.2%**	**12,908**	**12.3%**
Income taxes	930	0.9%	734	0.8%	1,165	1.0%	948	0.9%
Net Income	**11,836**	**11.4%**	**10,525**	**10.9%**	**13,409**	**11.2%**	**11,960**	**11.4%**

Source: Erste Group Research, according to IFRS

Expanding share of bulk chemicals, deteriorating currency situation to keep lid on gross margin

The sharply expanding proportion of bulk chemicals, combined with the y/y less favorable forex situation and home market price erosion, was offset by improving territorial (increased share of Russia) and product sales mix and Egis' gross margin improved to 57.3% in 2Q2007/08. The positive impact from the increasing share of Russia/CIS sales will still be compromised by the swiftly advancing bulk chemical sales, as well as the less favorable currency situation. As a result, we remain on the conservative side and opt for only a marginal upward adjustment of our projections for the gross margin for FY2007/08 to 56.0% (vs. the earlier projected 55.9%).

EBIT margin recovery to above 10% mark in coming periods; cost savings efforts still hampered by unfavorable currency developments

The operating cost rise is envisaged to be kept under control. The 2Q2007/08 results provided more evidence of the company's management's commitment regarding operating expenses. The rise of R&D costs and (despite the 2Q y/y hike attributable to the low comparative base) administrative & general costs is envisaged to lag behind the sales tempo in 2007/08. While sales and marketing expenses fell by 0.2% y/y in 1H2007/08 to 22.2% of sales, for the full year 2007/08, we stick to our assumptions and forecast these expenditures at around 23% of sales. Given the more pronounced domestic sales slowdown than originally expected and the recent decision of the Constitutional Court declaring the fees for sales representatives as unconstitutional, the overall negative impact from the government's measures is anticipated to be less material in 2007/08 and reach HUF 2.3bn (down from the earlier envisaged HUF 2.4bn), out of which some HUF 1.9bn is attributable to the 12% rebate and HUF 0.4bn related to fees for sales reps. The ongoing efforts in cutting operating costs have unfortunately been undermined as of late by the swiftly appreciating forint. Based on the encouraging 1H07/08 data, we were keen to adjust our EBIT margin assumptions upwards. However, the recent forint rally prompts a more cautious approach. All things considered, we opt for a minor decrease of our operating margin target from 10.3% to 10.0%. Finally, factoring in the negative impact from the strongly appreciating forint on the reassessment of receivables, we trim our full fiscal year 2007/08 financial result from around HUF 2.1bn to HUF 1.7bn. All told, our new net profit target arrives at HUF 10,525mn for 2007/08 and HUF 11,960mn for 2008/09.

3Q2007/08 results preview

Egis is expected to publish its 1-3Q07/08 report on August 6, 2008, after market close. We envisage net profit of HUF 8,055mn, on sales of HUF 71,804mn for October 2007-June 2008, the first nine months of its 2007/08 fiscal year. In 3Q07/08 alone, we anticipate Egis' net profit at HUF 2,210mn, on sales of HUF 23,071mn.

3Q2007/08 results preview

IFRS nonconsolidated	3Q 07/08e	3Q 06/07	y/y	1-3Q2007/08e	1-3Q2006/07	y/y
Net sales (HUF mn)	23,071	24,296	*-5.0%*	71,804	69,422	*3.4%*
Operating profit (HUF mn)	2,086	1,932	*8.0%*	6,951	6,331	*9.8%*
Net income (HUF mn)	2,210	2,358	*-6.3%*	8,055	5,181	*55.5%*
Operating margin	*9.0%*	*8.0%*		*9.7%*	*9.1%*	
Net margin	*9.6%*	*9.7%*		*11.2%*	*7.5%*	

Source: Erste Group Research, Company data

Reflecting the significantly lower price levels y/y (with the major price cut taking place in April 2007, followed by several rounds of quarterly price reductions), we project Egis' domestic sales falling by some 9.5% y/y to HUF 7.07bn in 3Q07/08, sending the 1-3Q total to HUF 21.7bn, down 10.1% y/y. As indicated by earlier interim results, exports should maintain their dynamism and at least partly compensate for the domestic market sluggishness. While we envisage exports to Russia/CIS to continue in their recovery, reflecting the previous year's high comparative base (hiked by extraordinary shipments), we forecast them retreating by 2% y/y to USD 44.9mn in 3Q07/08. Nevertheless, this translates into a bold 12.6% y/y rise for Egis' Russia/CIS sales in the first nine months of 2007/08. In Russia alone, we expect Egis' sales at USD 32.0mn, down 10.5% y/y in 3Q07/08. Egis' Eastern European sales are anticipated to keep their momentum, rising by a hefty 44% y/y to USD 33.1mn in 3Q07/08. Although slowing down q/q, sales to Western markets are poised to see growth in double-digit terms. We anticipate Western markets sales rising by 10.6% y/y to USD 22.9mn, out of which bulk chemicals sales are envisaged to contribute USD 16mn in 3Q07/08. In summary, we forecast Egis' sales advancing by 3.4% y/y to HUF 71,804mn in 1-3Q07/08.

The y/y less favorable currency situation, worsening sales mix (in particular, the fast expanding proportion of bulk chemicals) and domestic drug price cuts will undoubtedly put a lid on Egis' profitability margins in 3Q07/08. Reflecting the ongoing cost containment measures and weak comparative base, we forecast 3Q07/08 EBIT advancing by 8.0% y/y to HUF 2,086mn, corresponding to an EBIT margin of 9.0% (up from 8.0% in the previous year's period). This translates into a 1-3Q07/08 EBIT target of HUF 6,951mn (and EBIT margin of 9.7%). With respect to the buoying effect from the sale of the Medimpex stake on the 2Q results, we expect the company's financial results not only to stay in the black in 1-3Q, but to post further improvement to HUF 1,504mn, out of which the 3Q07/08 financial result is projected to contribute HUF 290mn. All told, the company should be able to deliver a bold y/y move on the bottom line, with its 1-3Q07/08 net profit surging by 55.5% y/y to HUF 8,055mn, out of which the third quarter is expected to deliver HUF 2,210mn.

Valuation summary

Our new 12-month target price arrives at HUF 21,000 per share; Buy maintained

The increasing inflation fears put further pressure on interest rate hikes and lift bond yields. This prompts us to revise the parameters of our DCF model, namely the risk-free rate applied - we opt to raise it from 6.6% to 7.4% for the detailed forecast period of 2008-14. Applying the market premium for the forecasted period and perpetuity of 5%, we arrive at a WACC of 11.6% for 2008-14 and 10.0% for perpetuity. After incorporating these changes into our forecasts and DCF model parameters, our DCF-derived 12-month target price amounts to HUF 21,000 per share, below our earlier target price of HUF 24,400. Although some risks remain (especially with regards to the still unclear currency developments), we believe that the worst is more than fully priced in. We continue to believe that the current market price fails to adequately reflect the company's transparency, as well as its recently intensifying efficiency drive, supported by its solid position in CEE markets and booming Russia. We stick to our Buy recommendation on Egis.

Free cash flow forecasts

HUF mn	07/08e	08/09e	09/10e	10/11e	11/12e
EBIT	9,599	11,617	14,706	17,400	20,893
Depreciation	6,472	6,982	7,619	8,279	8,988
EBITDA	16,071	18,600	22,325	25,678	29,881
Investments	-8,332	-9,962	-10,676	-11,518	-12,422
Change in working capital	-1,738	-2,951	-4,886	-5,789	-6,427
Corporate income taxes	734	948	1,369	1,738	2,210
Free cash flow	5,268	4,739	5,393	6,634	8,822

DCF valuation

Key parameters of DCF valuation

	08-14e	perpetuity		
beta	0.84	1.0	PV of the FCF (HUF mn)	34,110
risk free rate (%)	7.4%	5.0%	PV of TV (HUF mn)	99,786
market premium (%)	5.0%	5.0%	Total (HUF mn)	133,895
WACC (%)	11.6%	10.0%	+net cash (HUF mn)	15,274
perpetuity cash flow growth rate (%)		3.5%	Equity value of the company (HUF mn) as of 30.9.2008	149,169
			Equity value per share (HUF) as of 30.9. 2008	19,159
			Equity value per share (HUF) as of 31.7. 2009	21,000

Equity value per share (HUF) as of 31.7. 2009

		Discount rate				
		9.5%	*10.0%*	*10.5%*	*11.0%*	*11.5%*
Perpetuity cash flow growth rate	*2.5%*	21,608	20,225	19,018	17,957	17,017
	3.0%	22,714	21,157	19,812	18,638	17,606
	3.5%	24,003	22,232	20,719	19,411	18,270
	4.0%	25,527	23,487	21,765	20,294	19,022
	4.5%	27,356	24,970	22,986	21,312	19,881

Source: Erste Group Research

Income Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, HUF mn, 30/09)	30/09/2005	30/09/2006	30/09/2007	30/09/2008	30/09/2009	30/09/2010
Net sales	**72,621.39**	**87,361.52**	**92,489.00**	**96,127.79**	**105,350.73**	**123,972.40**
Cost of goods sold	-28,428.83	-31,497.58	-41,121.00	-42,262.28	-45,738.16	-53,311.46
Gross profit	**44,192.56**	**55,863.94**	**51,368.00**	**53,865.51**	**59,612.58**	**70,660.94**
SG&A	-26,363.70	-31,899.32	-32,919.00	-33,220.46	-36,154.19	-42,548.32
Other operating revenues	226.44	163.76	623.00	570.05	572.90	581.49
Other operating expenses	-7,745.66	-8,649.00	-11,009.00	-11,615.94	-12,413.95	-13,987.84
EBITDA	**15,061.65**	**20,944.37**	**14,265.00**	**16,071.30**	**18,599.64**	**22,325.18**
Depreciation/amortization	-4,752.00	-5,465.00	-6,202.00	-6,472.15	-6,982.32	-7,618.91
EBIT	**10,309.65**	**15,479.37**	**8,063.00**	**9,599.15**	**11,617.32**	**14,706.27**
Financial result	1,533.12	2,240.38	-155.00	1,659.22	1,290.40	1,442.00
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**11,842.77**	**17,719.76**	**7,908.00**	**11,258.37**	**12,907.72**	**16,148.27**
Income taxes	-1,533.30	-2,194.72	-244.00	-733.59	-948.00	-1,369.27
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	**10,309.47**	**15,525.04**	**7,664.00**	**10,524.78**	**11,959.72**	**14,778.99**

Balance Sheet	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, HUF mn, 30/09)						
Intangible assets	512.36	549.03	600.00	660.00	726.00	798.60
Tangible assets	34,727.64	38,838.68	42,582.00	46,711.35	51,143.93	55,734.41
Financial assets	8,618.22	8,693.55	10,140.00	10,900.50	11,718.04	12,596.89
Total fixed assets	**43,858.21**	**48,081.26**	**53,322.00**	**58,271.85**	**63,587.97**	**69,129.90**
Inventories	25,306.48	28,373.09	28,604.00	29,729.37	31,767.19	34,952.47
Receivables and other current assets	18,703.20	20,588.25	22,443.00	23,325.97	24,924.88	28,010.69
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	6,555.11	9,606.68	10,778.00	15,273.96	19,078.26	23,536.69
Total current assets	**50,564.78**	**58,568.02**	**61,825.00**	**68,329.30**	**75,770.33**	**86,499.86**
TOTAL ASSETS	**94,423.00**	**106,649.28**	**115,147.00**	**126,601.15**	**139,358.30**	**155,629.76**
Shareholders'equity	**81,067.78**	**95,658.87**	**102,388.72**	**111,979.21**	**123,004.65**	**136,849.35**
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	1,285.26	1,307.68	1,692.00	1,666.62	1,641.62	1,617.00
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	1,951.06	0.00	0.00	0.00	0.00	0.00
Other ST liabilities	10,118.90	9,682.73	11,066.29	12,955.32	14,712.03	17,163.41
Total short-term liabilities	**9,655.01**	**7,309.23**	**9,226.00**	**9,543.54**	**10,277.23**	**11,710.72**
TOTAL LIAB. , EQUITY	**94,423.00**	**106,649.28**	**115,147.00**	**126,601.15**	**139,358.30**	**155,629.76**

Cash Flow Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS,HUF mn, 30/09)						
Cash flow from operating activities	9,922.98	12,307.77	13,694.00	13,599.93	14,700.68	16,069.42
Cash flow from investing activities	-8,209.59	-9,028.13	-10,144.00	-8,332.35	-9,961.80	-10,676.40
Cash flow from financing activities	-934.23	-2,868.89	-934.29	-771.62	-934.59	-934.59
CHANGE IN CASH , CASH EQU.	**779.16**	**410.75**	**2,615.71**	**4,495.96**	**3,804.30**	**4,458.44**

Margins & Ratios	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Sales growth	nm	20.3%	5.9%	3.9%	9.6%	17.7%
EBITDA margin	20.7%	24.0%	15.4%	16.7%	17.7%	18.0%
EBIT margin	14.2%	17.7%	8.7%	10.0%	11.0%	11.9%
Net profit margin	14.2%	17.8%	8.3%	10.9%	11.4%	11.9%
ROE	25.4%	17.6%	7.7%	9.8%	10.2%	11.4%
ROCE	25.2%	18.4%	7.9%	10.4%	11.1%	12.8%
Equity ratio	85.9%	89.7%	88.9%	88.5%	88.3%	87.9%
Net debt	-4,604.0	-9,606.7	-10,778.0	-15,274.0	-19,078.3	-23,536.7
Working capital	40,909.8	51,258.8	52,599.0	58,785.8	65,493.1	74,789.1
Capital employed	77,749.0	87,359.9	93,302.7	98,371.9	105,568.0	114,929.7
Inventory turnover	2.2	1.2	1.4	1.4	1.5	1.6

Source: Company data, Erste Group estimates

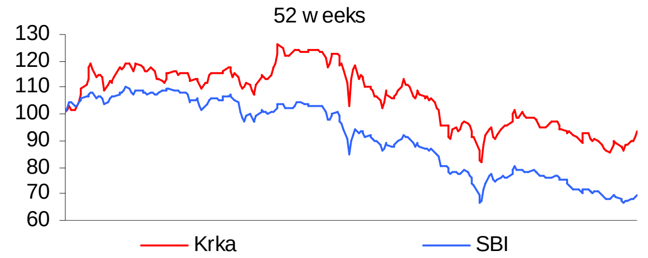
Sector Report – CEE Pharmaceuticals

Company Report – Pharmaceuticals – Slovenia – July 28, 2008

Krka Buy

Vladimira Urbankova, MBA +43 50100 17343 vladimira.urbankova@erstebank.at

EUR mn	2007	2008e	2009e	2010e
Net sales	780.9	950.9	1,123.5	1,305.9
EBITDA	239.9	288.7	337.9	390.4
EBIT	182.9	224.7	266.5	310.9
Net result after min.	132.6	167.1	202.3	240.5
EPS (EUR)	3.7	4.7	5.7	6.8
CEPS (EUR)	5.9	6.4	7.5	8.8
BVPS (EUR)	18.9	22.9	27.7	33.2
Div./share (EUR)	0.9	1.2	1.5	1.8
EV/EBITDA (x)	19.0	11.9	10.1	8.6
P/E (x)	33.2	19.8	16.3	13.7
P/CE (x)	20.9	14.5	12.4	10.6
Dividend Yield	0.7%	1.3%	1.6%	1.9%



Performance	12M	6M	3M	1M
in EUR	-7.7%	-20.0%	3.2%	2.8%

Share price (EUR)	93.33	Reuters	KRKG.LJ	Free float	67.7%
Number of shares (mn)	35.4	Bloomberg	KRKG SV	Shareholders	KAD & PPS (15.0%)
Market capitalization (EUR mn)	3,306.3	Div. Ex-date	07/07/08		SOD Fund (9.5%)
Enterprise value (EUR mn)	4,550.7	**Target price**	**125.0**	Homepage:	www.krka.si

Still ahead of peers

– **Our revised DCF-derived 12-month target price arrives at EUR 125 per share, marginally down from the earlier value of EUR 127.5 per share. The relatively low foreign share ownership (at just 4.6% of the total) did not protect Krka from the recent sell-off wave that spilled across equity markets. After the slump, Krka maintained its premium to its CEE-based rivals, which we continue to believe is fully justified by the company's superior tempo (which is not confined to the top line) and very sound outlook, based on its solid regional position and strong R&D pipeline, warranting success in Western markets, as well as above-average profitability parameters. All things considered, we confirm our Buy recommendation on the stock.**

– **Krka's 2008 interim performance data remains very impressive, reassuring investors that the company is heading for another successful year. Consequently, the changes to our model are minimal, reflecting 1) the better than envisaged gross and operating profitability, but also somewhat weaker financial result in 1Q08; and 2) adjustments to the parameters of our DCF model - in particular, raising the risk-free rate assumptions.**

– **The 1H08 sales highlights indicate that our full-year target for 2008 (sales of EUR 950.9mn) is realistic, with the top line up by a hefty 20% y/y to EUR 469.3mn, fuelled by expanding exports - in particular to CEE (up 22% y/y) and Western European markets (up 46% y/y). While we fine-tuned our gross and operating margin assumptions (raising the gross margin forecast to 64.0% and EBIT margin to 23.6%), we also believe that our 2008 net profit target of EUR 167.1mn is achievable.**

– **We continue to assume that, supported by the improving sales structure (with an increasing share of new products) and ongoing efficient cost control, the company will be able to deliver a double-digit tempo on the operating and net profit lines in the first half of 2008. In summary, we forecast the company posting sales of EUR 469.3mn (up 20% y/y), operating profit of EUR 112.3mn (up 23.5% y/y) and net profit of EUR 80.8mn (up 18.8% y/y) in 1H 08 (all figures consolidated and according to IFRS).**

Changes in forecast/outlook

1H2008 sales performance signaled that excellent tempo is set to continue

For the time being, we opted for a minor revision of our 2008 sales forecasts by territory, reflecting the faster than anticipated tempo, particularly in CEE markets and Russia/CIS, but also more subdued sales in SEE countries, namely in Romania. The better than expected results prompt us to raise our Central European sales projections from EUR 244mn to EUR 245.6mn, corresponding to a 21.4% y/y rise in 2008. We also increase our target for Krka's sales in Russia/CIS from EUR 213mn to USD 221.8mn, translating into a 21.2% y/y rise in euro terms in 2008. On the other hand, we trim our sales estimate for SEE markets from EUR 158mn to EUR 147.3mn for 2008. All told, we leave our sales target for 2008 unchanged at EUR 950.9mn, corresponding to 21.8% y/y growth. We also stick to our earlier sales forecast for 2009 of around EUR 1,123.5mn (up by 18% y/y).

Changes to 2008 and 2009 forecasts

EUR mn	2008 orig. forecast		2008 new forecast		2009 orig. forecast		2009 new forecast	
Net sales	**950.9**	**100.0%**	**950.9**	**100.0%**	**1,123.5**	**100.0%**	**1,123.5**	**100.0%**
Costs of good sold	343.5	36.1%	342.7	36.0%	404.9	36.0%	404.3	36.0%
Gross profit	607.4	63.9%	608.2	64.0%	718.6	64.0%	719.2	64.0%
Sales & marketing exp.	241.2	25.4%	241.2	25.4%	284.2	25.3%	284.8	25.3%
Research & development exp.	74.2	7.8%	74.2	7.8%	88.8	7.9%	88.8	7.9%
General & administrative exp.	75.1	7.9%	75.1	7.9%	87.6	7.8%	88.8	7.9%
Other operating income	6.9	0.7%	6.9	0.7%	9.5	0.9%	9.5	0.9%
Operating profit	**223.8**	**23.5%**	**224.7**	**23.6%**	**267.6**	**23.8%**	**266.5**	**23.7%**
Financial result	-6.2	-0.7%	-7.0	-0.7%	-5.9	-0.5%	-6.5	-0.6%
Income taxes	50.0	5.3%	50.1	5.3%	57.6	5.1%	57.2	5.1%
Minorities	0.4	0.0%	0.4	0.0%	0.5	0.0%	0.5	0.0%
Net income	**167.1**	**17.6%**	**167.1**	**17.6%**	**203.6**	**18.1%**	**202.3**	**18.0%**

Source: Erste Group Research

While slightly raising gross and EBIT margin assumptions going forward…

…given weaker financial results, we stick to our net profit target

We also cautiously revise our 2008 gross and EBIT targets slightly upward to EUR 608.2mn and EUR 224.7mn, respectively, assuming more efficiencies stemming from a better sales mix and cost control. This translates into an increase in our gross margin forecast from 63.9% to 64.0% and a hike in the EBIT margin target from 23.5% to 23.6%. As before, the biggest question mark hangs over the level of necessary new provisioning (burdening sales and marketing costs) and the release of previous provisions (pushing up other income). For the time being, we opt to stick to our earlier assumptions and forecast the level of provisioning to decrease (but not materially) in 2008, from EUR 14.1mn in 2007 to EUR 12mn. We project sales and marketing costs at 25.4% of total 2008 sales. Reflecting the somewhat worse than earlier expected 1Q08 financial result, we are prompted to revise our forecast for the financial result downward. Nevertheless, as the major factors behind this change (forex related losses and the switch to euro invoicing in Russia) should bring more tangible results only later in the course of the year, our adjustments are not substantial; from a EUR 6.2mn loss to a EUR 7.0mn loss. In summary, our net profit target for 2008 is unchanged at EUR 167.1mn. For 2009, reflecting the increasingly positive earnings contribution from TAD Pharma (Krka's German acquisition), we see our net profit target of EUR 202.3mn as achievable.

1H2008 results preview

Krka released its 1H2008 sales performance highlights on July 3, limiting the scope for surprise in its top line figure with the release of the full 1H2008 report on July 30. (However, based on past experience, we have to emphasize that the reported numbers could still show some slight deviations, while providing more insight). It was very encouraging to see that Krka's fascinating tempo has yet to slip back. Consolidated sales advanced by some 20% y/y to EUR 469.3mn. In line with expectations, the growth was driven by exports, rising by 22% y/y to EUR 418.1mn and representing some 89% of the total sales. The company did well in Central European markets, where its sales surged by 22% y/y to EUR 123.6mn (or 26% of the total sales in 1H2008).

Reflecting benefits from the TAD Pharma acquisition, the company also managed to maintain its excellent sales tempo in Western Europe and overseas markets, where its sales surged by 46% y/y to EUR 106.3mn, or nearly 23% of total sales. As expected, the year-earlier period's low comparative base (with Russian sales plagued by the receivables collection-troubled DLO system) worked in favor of the y/y acceleration of Krka's Russia/CIS sales tempo. In 1H2008, Krka's sales in Russia/CIS grew by 17% y/y to EUR 119.4mn, or 25% of the total.

1H results preview

IFRS consolidated	2Q 2008e	2Q 2007	*y/y*	1H2008e	1H2007	*y/y*
Total sales (EUR 000)	224,916	188,319	*19.4%*	469,300	392,532	*19.6%*
Operating profit (EUR 000)	49,591	39,939	*24.2%*	112,335	90,925	*23.5%*
Net income (EUR 000)	36,719	29,890	*22.8%*	80,783	67,975	*18.8%*
Operating margin	*22.0%*	*21.2%*		*23.9%*	*23.2%*	
Net margin	*16.3%*	*15.9%*		*17.2%*	*17.3%*	

Source: Erste Group Research, Company data

We anticipate that Krka will maintain its solid profitability in the second quarter, helped by continuous improvements in the sales mix (namely an increasing share of new products with higher margins), as well as cost containment measures. We forecast Krka's operating profit at EUR 112.3mn in 1H2008, out of which the second quarter is expected to contribute EUR 49.6mn. Assuming a q/q improving financial result, we project net profit amounting to EUR 80.8mn in 1H (out of which EUR 36.7mn is foreseen to be added in 2Q08).

Valuation Summary

We raise our risk-free rate assumptions

Our new target price arrives at EUR 125.0…

Slovenia is the only new EU member to have adopted the euro (in January 2007). While this implies a somewhat lower risk-free rate than would be applied for the home countries of its regional peers, the upward moves in the yields of government bonds in the EU prompt us to revise the risk-free rate assumptions here as well, from the earlier 4.5% to 4.9% for 2008-12. For perpetuity, we continue to apply a risk-free rate of 5%. This sends our calculated WACC to 9.0% for 2008-12 and 9.9% for perpetuity. Incorporating also the changing time-frame into our model (compared to our previous report from April 2008), we arrive at a new DCF-derived 12-month target price of EUR 125.0 per share, marginally down from the earlier value of EUR 127.5 per share.

…reassuring us that recent equity market turbulence sent share price to very attractive levels

Consequently, we stick to Buy

In contrast with the previous market turbulence, Krka was not spared and shared in the big slump together with its regional peers during the weeks of equity market turmoil. Consequently, while the stock largely retained its premium to the CEE sector average, we believe that this is fully justified and that its share price offers interesting upside potential. We like Krka's growth story and appreciate its fast tempo, which is not limited to the top line. The company maintains its regional competitive edge in terms of profitability parameters, owing to its ability to translate its R&D spending into successful product launches in key areas for growth, such as cardiovascular diseases. We believe that the company is well positioned to reap benefits from its strong position in booming Russia, as well as maintain its dynamism in Western markets (not least thanks to its R&D pipeline, which is rich in products awaiting patent expirations). The mulled acquisitions point to untapped growth potential and could represent another trigger for the stock. All told, we confirm our Buy recommendation on Krka.

DCF valuation

Free cash flow forecasts (EUR mn)	2008e	2009e	2010e	2011e	2012e
EBIT	224.7	266.5	310.9	362.7	423.1
Depreciation	64.1	71.4	79.5	88.4	98.4
EBITDA	288.7	337.9	390.4	451.1	521.5
Investments	-120.3	-117.6	-118.7	-120.7	-122.7
Change in working capital	-33.7	-35.5	-36.4	-37.8	-39.5
Corporate income taxes	-50.1	-57.2	-64.1	-71.6	-84.0
Free cash flow	84.7	127.6	171.2	221.0	275.3

	2008-2012	perpetuity		
			PV of the FCF (EUR mn)	711.9
beta	0.84	1.00	PV of the TV (EUR mn)	3,263.7
risk free rate (%)	4.9%	5.0%	Total (EUR mn)	3,975.6
market premium (%)	5.0%	5.0%	- net debt (EUR mn)	-137.5
WACC (%)	9.0%	9.9%	Equity value of the company (EUR mn) as of 31.12. 2007	3,838.1
perpetuity cash flow growth rate (%)		4.5%	Equity value per share (EUR) as of 31.12. 2007	108.3
			Equity value per share (EUR) as of 31.7. 2009	125.0

Equity value/share (EUR) as of 31.7. 2009		discount rate				
		8.75%	**9.25%**	**9.75%**	**10.25%**	**10.75%**
	3.5%	131.1	118.7	108.4	99.6	92.0
	4.0%	142.9	128.3	116.2	106.1	97.5
perpetuity cash flow growth rate	**4.5%**	157.5	139.8	125.5	113.8	103.9
	5.0%	176.0	154.1	136.8	122.9	111.4
	5.5%	200.1	172.1	150.8	133.9	120.3

Source: Erste Group Research

Income Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, EUR mn, 31/12)	31/12/2005	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Net sales	**554.14**	**667.95**	**780.92**	**950.89**	**1,123.46**	**1,305.86**
Cost of goods sold	-216.41	-248.99	-282.83	-342.67	-404.25	-468.24
Gross profit	**337.72**	**418.97**	**498.09**	**608.22**	**719.20**	**837.62**
SG&A	-229.56	-219.39	-260.30	-316.28	-373.53	-432.70
Other operating revenues	51.01	3.56	4.22	6.89	9.55	9.79
Other operating expenses	-40.12	-52.65	-59.07	-74.17	-88.75	-103.82
EBITDA	**164.85**	**198.20**	**239.88**	**288.73**	**337.90**	**390.36**
Depreciation/amortization	-45.79	-47.70	-56.94	-64.06	-71.43	-79.46
EBIT	**119.06**	**150.50**	**182.93**	**224.67**	**266.47**	**310.90**
Financial result	4.20	-1.74	-8.00	-7.05	-6.54	-5.75
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**123.26**	**148.76**	**174.93**	**217.62**	**259.93**	**305.15**
Income taxes	-25.92	-36.67	-42.08	-50.05	-57.18	-64.08
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-0.13	-0.41	-0.30	-0.44	-0.48	-0.53
Net result after minorities	**97.21**	**111.68**	**132.55**	**167.13**	**202.27**	**240.54**

Balance Sheet	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, EUR mn, 31/12)						
Intangible assets	21.11	23.61	129.85	128.36	126.94	125.60
Tangible assets	451.49	506.82	572.24	640.91	717.82	803.96
Financial assets	30.18	44.42	47.61	59.51	74.39	96.33
Total fixed assets	**502.78**	**574.85**	**749.71**	**828.79**	**919.16**	**1,025.89**
Inventories	120.91	115.93	171.65	196.47	221.68	248.00
Receivables and other current assets	151.93	177.96	184.28	211.40	240.41	270.56
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	12.64	10.40	15.78	27.62	41.43	62.15
Total current assets	**285.48**	**304.28**	**371.71**	**435.48**	**503.52**	**580.71**
TOTAL ASSETS	**788.26**	**879.13**	**1,121.42**	**1,264.27**	**1,422.68**	**1,606.60**
Shareholders'equity	**472.01**	**563.00**	**670.88**	**809.67**	**979.69**	**1,177.72**
Minorities	**7.57**	**7.91**	**10.04**	**10.04**	**10.04**	**10.04**
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	98.71	122.55	143.64	140.05	133.05	126.40
Interest-bearing LT debts	48.71	34.58	87.18	78.46	62.77	50.22
Other LT liabilities	3.05	6.80	22.95	26.16	26.16	16.48
Total long-term liabilities	**51.76**	**41.39**	**110.13**	**104.63**	**88.93**	**66.70**
Interest-bearing ST debts	65.99	55.79	66.14	67.33	65.12	58.10
Other ST liabilities	92.22	88.49	120.59	132.56	145.85	167.64
Total short-term liabilities	**158.21**	**144.28**	**186.73**	**199.89**	**210.97**	**225.75**
TOTAL LIAB. , EQUITY	**788.26**	**879.13**	**1,121.42**	**1,264.27**	**1,422.68**	**1,606.60**

Cash Flow Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS,EUR mn, 31/12)						
Cash flow from operating activities	109.59	140.63	175.20	175.45	198.83	216.99
Cash flow from investing activities	-89.11	-111.54	-204.95	-120.25	-117.60	-118.69
Cash flow from financing activities	-19.74	-30.97	35.36	-43.36	-67.42	-77.59
CHANGE IN CASH , CASH EQU.	**0.74**	**-1.87**	**5.61**	**11.84**	**13.81**	**20.72**

Margins & Ratios	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Sales growth	nm	20.5%	16.9%	21.8%	18.1%	16.2%
EBITDA margin	29.7%	29.7%	30.7%	30.4%	30.1%	29.9%
EBIT margin	21.5%	22.5%	23.4%	23.6%	23.7%	23.8%
Net profit margin	17.6%	16.8%	17.0%	17.6%	18.0%	18.5%
ROE	41.2%	21.6%	21.5%	22.6%	22.6%	22.3%
ROCE	29.1%	15.6%	15.4%	16.3%	17.5%	18.6%
Equity ratio	60.8%	64.9%	60.7%	64.8%	69.6%	73.9%
Net debt	102.1	80.0	137.5	118.2	86.5	46.2
Working capital	127.3	160.0	185.0	235.6	292.6	355.0
Capital employed	683.4	780.2	985.0	1,104.1	1,235.4	1,376.8
Inventory turnover	3.6	2.1	2.0	1.9	1.9	2.0

Source: Company data, Erste Group estimates

Richter Gedeon Buy

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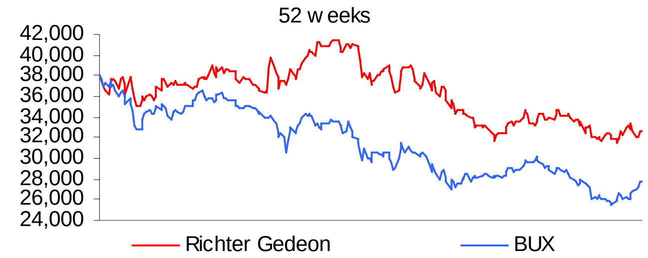
HUF mn	2007	2008e	2009e	2010e
Net sales	224,076.0	240,352.2	279,465.9	329,818.8
EBITDA	56,496.0	62,667.2	74,112.6	89,772.1
EBIT	36,283.0	41,716.7	50,638.4	63,831.3
Net result after min.	33,336.0	38,379.0	49,279.3	62,860.3
EPS (HUF)	1,788.7	2,059.2	2,644.1	3,372.8
CEPS (HUF)	2,873.2	3,183.3	3,903.6	4,764.6
BVPS (HUF)	16,428.3	18,032.5	19,976.6	22,499.4
Div./share (HUF)	450.0	600.0	700.0	850.0
EV/EBITDA (x)	12.9	8.7	7.1	5.6
P/E (x)	23.2	15.8	12.3	9.7
P/CE (x)	14.4	10.2	8.3	6.8
Dividend Yield	1.1%	1.8%	2.1%	2.6%



Performance	12M	6M	3M	1M
in HUF	-14.4%	-13.1%	-1.1%	2.2%
in EUR	-9.2%	-3.7%	7.4%	5.0%

Share price (HUF)	32595.00	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)	607,489 / 2,614	Div. Ex-date	05/06/08		
Enterprise value (HUF mn / EUR mn)	727,278 / 2,877	**Target price**	**41,100.0**	Homepage:	www.richter.hu

Prospects remain sound despite Polpharma deal failure

– **Richter is expected to announce its 2Q08 results in early August 2008 (no precise date is known yet). We expect Richter to post 2Q08 net profit of HUF 6,732mn, on sales of HUF 43,452mn (unconsolidated and according to IFRS standards). On the consolidated basis, we project Richter's net profit at HUF 8,322mn on sales of HUF 59,626mn. We set our consolidated net profit target for 2008 at HUF 38,379mn, on sales of HUF 240,352mn; for 2009, we project net profit of HUF 49,279mn on sales of HUF 279,466mn. Our DCF-derived 12-month target price (based on consolidated data) arrives at HUF 41,100 per share, below the earlier target of HUF 47,300 (which was based on an unconsolidated model).**

– All told, we continue to believe that the stock's upside potential remains attractive and that the depressed stock price does not reflect Richter's sound territorial and product niche strategy, or its strong management team track record. The collapsed Polpharma transaction can be compensated for to a large extent by future potential acquisitions and/or a reinforced focus on organic growth in the targeted Polish and Russian markets. Paradoxically, we appreciate that - after the failure - the risks associated with the stock also significantly decreased (especially those related to the earlier underestimated corporate governance issues), while the breakup penalty will cover transaction costs. We stick to Buy.

– **Although the Polpharma deal failed to go through, we believe that the consolidated accounts provide a more complete picture of the company. Consequently, we opted to prepare consolidated forecasts alongside the traditional unconsolidated ones. The most important factors newly incorporated into our model include the following: 1) the negative consequences of the persisting domestic market sluggishness; 2) the revised exchange rate, with the weaker than anticipated US dollar partly offset by the switch to euro invoicing in Russia, but stronger than envisaged forint working against Richter; and 3) adjustments to our DCF model parameters, namely raising the risk-free rate. This sent our new unconsolidated net profit forecast to HUF 39,547mn in 2008 and HUF 49,664mn in 2009, down 12% and 9.8%, respectively.**

Changes in forecasts/outlook

Pricing pressures, stronger forint continue to bite into Richter's sales

As with Egis, the persisting pricing pressures related to periodical changes in reference prices continue to bite into Richter's domestic sales. Consequently, reflecting the revised company guidance, we cut our target and envisage that Richter's domestic sales will fall by as much as 7% in HUF terms in 2008 (vs. the earlier estimate of a 4% y/y drop). For the outlook on the export side, a positive note prevails. Nevertheless, reflecting the timing of shipments, sales in the US are projected be weaker than originally anticipated and end flat or even modestly lower y/y in 2008, calling for a sizable downward correction to our sales target for the US market from USD 123mn to some USD 110mn. On an encouraging note, bolstered by the switch from the US dollar to euro invoicing, Russian sales are picking up quicker than we originally anticipated. As a result, we opt for an upward adjustment here, raising our sales target to EUR 205mn (up by around 12% y/y), translating into a 24% y/y rise in USD terms in 2008 (vs. the originally projected 17.5% y/y growth in USD terms). For Russia/CIS, we envisage the growth tempo at some 13% y/y in euro terms to EUR 293mn in 2008. With 1Q2008 results only marginally better than we projected, we leave our forecasts for sales to the EU unchanged and expect them to increase by around 10% y/y in euro terms in 2008. Finally, we incorporate the new exchange rate forecast, revising the average exchange rate from HUF 182.4/USD to HUF 161.8/USD for 2008 and from HUF 196.2/USD to HUF 175.0/USD for 2009 (and an average exchange rate of HUF 259/EUR to HUF 246/EUR for 2008 and HUF 255/EUR to HUF 245/EUR for 2009). After incorporating all the above-mentioned changes and, in particular, the dampening effect of the firming forint, our unconsolidated sales target for 2008 arrives at HUF 180,886mn, down from the previous forecast of HUF 195,074mn. For 2009, our new unconsolidated sales target is HUF 218.1bn, down from the earlier HUF 237.3bn.

We trim our 2008 unconsolidated sales target to HUF 180.9bn

Richter's takeover of Polpharma failed, removing some clouds (but also upside potential) from horizon

All the steps with respect to the acquisition and consolidation of Polpharma were in line with earlier plans and the actual time for closing the transaction was envisaged at mid-2008, depending on legal approval of transaction pending in Poland. Surprisingly, on the same day that the deal obtained approval from the Polish Competition Authority, July 3, Richter received a termination notification from Genefar in relation to the agreement between Richter and Genefar on the acquisition of 99.65% of shares in Polpharma (valued at USD 1.3bn), which had been publicly announced on November 15, 2007. On July 6, 2008, representatives and financial and legal advisors of Richter and Genefar met in Budapest to clarify the situation. However, no agreement was reached. According to Richter, Genefar, an investment vehicle of Polish businessman Jerzy Starak, had asked Richter to provide additional rights and benefits and to release Genefar from certain obligations stipulated by the original agreement signed and approved later on by Richter's shareholders at the EGM in December 2007. Richter said that it disagrees with Genefar's position, but is committed to completing the deal under the original terms. Richter scheduled the date for closing and for the subscription of new shares (the transaction was an all-share deal via private placement at a price set at HUF 37,154 per Richter share) for July 14, 2008, but the representatives of Genefar failed to turn up at the closing meeting. As Genefar no longer wishes to complete the deal on the original terms, Richter will take necessary steps to enforce its claim for the breakup penalty amounting to USD 40mn.

Consolidated picture is gaining importance…

…prompting us to prepare a valuation model based on consolidated results

While the transaction promising to catapult Richter into the regional number one spot (with 2006 pro-forma sales reaching USD 1,336mn) was erased from Richter's future plans, we still feel that the consolidated picture is gaining importance and relevance for the valuation of the company, prompting us to prepare a valuation model based on consolidated results. On the sales side, the difference compared to the unconsolidated accounts comprises most importantly the inclusion of the Romanian-based pharmaceutical wholesale and retail activities, along with results from key foreign manufacturing subsidiaries Polfa Grodzisk in Poland and Richter's Russian operations. We forecast Richter's consolidated sales at HUF 240.35bn in 2008 (up 7.3% y/y), with some HUF 38.6bn to be delivered by wholesale and retail operations and HUF 201.8bn to be contributed by the pharmaceutical business segment. For 2009, we project consolidated sales growth of 16.3% y/y to HUF 279.5bn, out of which HUF 237bn is expected to come from the pharmaceutical segment and HUF 42.4bn from the wholesale and retail arm.

Changes to unconsolidated 2008 and 2009 forecasts

(HUF mn)	2008 orig. forecast		2008 new forecast		2009 orig. forecast		2009 new forecast	
Sales	**195,074**	**100.0%**	**180,886**	**100.0%**	**237,299**	**100.0%**	**218,076**	**100.0%**
Cost of sales	75,534	38.7%	70,247	38.8%	91,484	38.6%	84,054	38.5%
Gross profit	**119,540**	**61.3%**	**110,639**	**61.2%**	**145,815**	**61.4%**	**134,021**	**61.5%**
Sales and marketing costs	39,827	20.4%	36,920	20.4%	48,850	20.6%	44,883	20.6%
Admin.and general costs	10,936	5.6%	10,138	5.6%	13,317	5.6%	12,233	5.6%
R&D costs	20,527	10.5%	19,029	10.5%	25,052	10.6%	23,018	10.6%
Other income/expense	-5,117	-2.6%	-4,998	-2.8%	-5,320	-2.2%	-5,198	-2.4%
Operating profit	**43,133**	**22.1%**	**39,553**	**21.9%**	**53,277**	**22.5%**	**48,690**	**22.3%**
Net financial income	3,218	1.6%	1,218	0.7%	3,511	1.5%	2,511	1.2%
Profit before taxation	46,351	23.8%	40,771	22.5%	56,788	23.9%	51,200	23.5%
Taxation	1,391	0.7%	1,223	0.7%	1,704	0.7%	1,536	0.7%
Net profit	**44,960**	**23.0%**	**39,547**	**21.9%**	**55,084**	**23.2%**	**49,664**	**22.8%**

Source: Erste Group Research

Despite negative impact from stronger forint unconsolidated EBIT margin should still exceed 20% mark

With 1Q2008 unconsolidated results broadly in line with our expectations, we opt for a minor fine-tuning of our projections. In particular, to reflect the stronger than earlier projected forint, we decrease our gross margin target to 61.2% (from 61.3%), as well as the operating profit target to 21.9% (down from 22.1%). Research and development costs are envisaged to speed up and reach around 10.5% of 2008 sales. Sales and marketing costs are projected at around 20.4% for the full year 2008 (the recent abolition of the sales rep fees plays a supportive role for cost savings here). On the other hand, as a consequence of different interpretation of the drug economic act, the company expects a significant (HUF 400mn to HUF 500mn) increase in the 12% rebate it is obliged to pay to the National Healthcare Fund. The total rebate related amount is hence envisaged to rise to HUF 1.3-1.4bn, up from the previous year's HUF 0.9bn. Similarly to Egis, Richter's financial result is coming under pressure once again, due to the appreciating forint's impact on reassessment of the company's receivables /payables balance, prompting us to make a cut to our original forecasts, from net financial income of HUF 3.2bn to HUF 1.2bn. In summary, our new unconsolidated net profit target arrives at HUF 39,547mn for 2008 and HUF 49,664mn for 2009, some 12% and 9.8%, respectively, below our original forecast.

Consolidated profitability parameters to continue to witness dilutive effect

A closer look at Richter's consolidated accounts clearly demonstrates the dilutive effect of the wholesale and retail operations, as well as the relatively high operating costs of sales and marketing-focused subsidiaries abroad. Our initial estimates for the gross and operating margins hence look for somewhat more subdued profitability parameters than the parent company traditionally enjoys. We forecast a gross margin of 54.3% and an EBIT margin of 17.4% for 2008, with targeted improvement to 55.4% and 18.1%, respectively, for 2009. Assuming an effective tax rate of 5% (due to the higher statutory tax rates abroad compared to Richter's near-tax haven in Hungary), our net profit forecast arrives at HUF 38,379mn for 2008 and HUF 49,279mn in 2009.

2Q2008 results preview

Richter is expected to announce its 2Q08 results in early August 2008 (no precise date is known yet). We expect Richter to post 2Q08 net profit of HUF 6,732mn, on sales of HUF 43,452mn (unconsolidated and according to IFRS standards). On the consolidated basis, we project Richter's net profit at HUF 8,322mn on sales of HUF 59,626mn.

2Q08 preview

IFRS non-consolidated	2Q 2008e	2Q 2007	*y/y*	1H2008e	1H2007	*y/y*
Total sales (HUF mn)	43,452	43,441	*0.0%*	86,711	84,528	*2.6%*
Operating profit (HUF mn)	9,001	8,678	*3.7%*	17,692	16,881	*4.8%*
Net income (HUF mn)	6,732	9,407	*-28.4%*	16,915	16,595	*1.9%*
Operating margin	*20.7%*	*20.0%*		*20.4%*	*20.0%*	
Net margin	*15.5%*	*21.7%*		*19.5%*	*19.6%*	

IFRS consolidated	2Q2008e	2Q2007	y/y	1H2008e	1H2007	y/y
Total sales (HUF mn)	59,626	60,220	-1.0%	116,652	111,237	4.9%
Operating profit (HUF mn)	10,132	9,505	6.6%	20,228	18,804	7.6%
Net income (HUF mn)	8,322	10,554	-21.2%	18,543	18,541	0.0%
Operating margin	*17.0%*	*15.8%*		*17.3%*	*16.9%*	
Net margin	*14.0%*	*17.5%*		*15.9%*	*16.7%*	

Source: Erste Group Research, Company data

The several rounds of price cuts associated with changes to reference prices starting in April 2007 on a quarterly basis are envisaged to take their toll, sending Richter's domestic drug prices well below the level recorded in 2Q07. Consequently, we forecast that Richter's unconsolidated domestic sales will see a 9.1% y/y fall to about HUF 7.2bn in 2Q08, bringing the 1H08 total to HUF 14.4bn, down by 11.7% y/y. Although sales within the DLO system are anticipated to remain a non-factor, sales growth in Russia – driven by the private market – is expected to notch up 8% y/y in 2Q08. We estimate that Richter's Russia/CIS sales will rise by a 8.5% y/y to EUR 69.0mn in 2Q08, lifting the 1H08 sales in this territory to EUR 138.0mn, up by 9.4% y/y. All told, we project Richter's exports advancing at 2.1% y/y in EUR terms in 2Q08 (translating into a 4.6 % y/y rise in 1H2008). However, with respect to the y/y appreciation of the Hungarian forint, as well as domestic market weakness, we expect Richter's sales to remain flat y/y at HUF 43.45bn in 2Q08 (and rise by 2.6% y/y to HUF 86.7bn in 1H08). We forecast consolidated sales growth of 4.9% y/y to HUF 116.7bn in 1H2008, with the high tempo partly attributable to acquisitions in the Romanian wholesale/retail operations more than offsetting the impact of the disposal of Richter's 50% stake in Medimpex. Reflecting the year earlier high comparative base, the 2Q2008 consolidated sales are estimated to decline by 1% y/y to HUF 59.6bn.

Richter's profitability is expected to witness persisting home market pricing pressures, as well as unfavorable currency developments (the y/y strengthening of the Hungarian forint vs. the US dollar as well as the euro). The company's cost saving efforts, along with the expanding share of Russian sales (and the switch to euro as the invoicing currency in Russia and, recently, in Kazakhstan), should nevertheless provide support to the company's profitability margins. On the unconsolidated basis, we forecast a 2Q2008 EBIT of HUF 9,001mn, translating into an EBIT margin of 20.7% (this compares with an EBIT margin of 20.0% in 2Q2007). Reflecting the y/y deteriorating financial result (driven by unrealized losses stemming from reassessment of receivables), the 2Q2008 parent company's bottom line is projected to slip by 28.4% y/y to HUF 6,732mn, tempering the 1H2008 net profit growth to 1.9% y/y. On the consolidated level, we project operating profit reaching HUF 10,132mn (up 6.6% y/y), corresponding to an EBIT margin of 17.0% in 2Q2008. Our consolidated net profit target is at HUF 8,322mn (down 21.2% y/y).

Valuation summary

We adjust our DCF model parameters, namely to reflect rising bond yields

Finally, we have adjusted the parameters of our DCF model. In order to reflect rising bond yields, we upped our risk-free rate assumptions from 7.0% to 7.9%, comparable to the current yield on the Hungarian 10-year government bond, for the detailed forecast period of 2008-12. With the market premium at 5%, we arrived at a WACC of 12.1% for 2008-12 and 10.0% for perpetuity. In summary, our DCF-derived 12-month target price (based on the consolidated model) is HUF 41,100 per share, below our earlier target of HUF 47,300 per share (derived from unconsolidated data). It is worth mentioning that the cancelled Polpharma deal was anticipated to lift our target price only marginally (due to the dilutive effect of the capital increase) to HUF 48,400 per share. As before, we want to emphasize that our model still does not involve any potential rewards the company may enjoy from its R&D cooperation projects with Forest Laboratories of the US, nor results from its recent foray into the biotech field. However, should these product candidates successfully pass the phase II clinical trial hurdle, we would revise our forecasts and raise our targets accordingly. A brief look at Richter's current share price level indicates that, while the stock shrugged off worries linked to the Polpharma deal failure, the stock price has yet to recover enough to capture the company's sound fundamentals and untouched export outlook (particularly to quickly advancing Russia), to say nothing of the possible lift from the R&D program's progress. We stick to our Buy recommendation on the stock.

All told, our new 12-month target price arrives at HUF 41,100 per share; Buy maintained

DCF valuation

Free cash flow forecast

HUF mn	2008e	2009e	2010e	2011e	2012e
EBIT	41,717	50,638	63,831	74,033	84,737
Depreciation	20,950	23,474	25,941	28,641	31,541
EBITDA	62,667	74,113	89,772	102,674	116,277
Investments	-26,032	-28,195	-29,922	-30,595	-32,478
Change in Working Capital	-8,281	-13,692	-18,246	-20,098	-22,021
Corporate income taxes	2,057	2,634	3,351	3,903	16,083
Free Cash Flow	26,298	29,592	38,253	48,078	45,696

	2008-2012	perpetuity
beta	0.84	1.0
risk free rate (%)	7.9%	5.0%
market premium (%)	5.0%	5.0%
WACC (%)	12.1%	10.0%
perpetuity cash flow growth rate (%)		4.0%
number of shares	18,637,486	

PV of the FCF (HUF mn)	146,212
PV of TV (HUF mn)	438,621
Total (HUF mn)	584,833
+net cash (HUF mn)	54,376
Equity value of the company (HUF mn)	639,209
Equity value per share (HUF) as of 31.12. 2007	34,297
Equity value per share (HUF) as of 31.7. 2009	41,100

Equity value per share (HUF) as of 31.7. 2009

		Discount rate				
		9.5%	10.0%	10.5%	11.0%	11.5%
Perpetuity cash flow	3.0%	42,088	39,342	36,965	34,889	33,607
growth rate	3.5%	44,481	41,346	38,664	36,342	34,889
	4.0%	47,309	43,685	40,623	38,003	36,342
	4.5%	50,703	46,450	42,910	39,919	38,003
	5.0%	54,850	49,767	45,612	42,155	39,919

Source: Erste Group Research

Income Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, HUF mn, 31/12)	31/12/2005	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Net sales	**172,597.00**	**209,373.00**	**224,076.00**	**240,352.17**	**279,465.88**	**329,818.78**
Cost of goods sold	-75,573.00	-89,704.00	-104,379.00	-109,889.48	-124,641.93	-143,789.61
Gross profit	**97,024.00**	**119,669.00**	**119,697.00**	**130,462.68**	**154,823.95**	**186,029.17**
SG&A	-43,683.00	-53,050.00	-58,208.00	-62,491.56	-73,778.99	-87,237.07
Other operating revenues	0.00	0.00	0.00	0.00	0.00	0.00
Other operating expenses	-13,750.00	-17,092.00	-25,206.00	-26,254.38	-30,406.53	-34,960.79
EBITDA	**56,179.00**	**68,276.00**	**56,496.00**	**62,667.21**	**74,112.56**	**89,772.11**
Depreciation/amortization	-16,588.00	-18,749.00	-20,213.00	-20,950.47	-23,474.13	-25,940.80
EBIT	**39,591.00**	**49,527.00**	**36,283.00**	**41,716.74**	**50,638.43**	**63,831.31**
Financial result	6,595.00	2,586.00	-503.00	-582.48	2,043.29	3,186.62
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**46,186.00**	**52,113.00**	**35,780.00**	**41,134.26**	**52,681.71**	**67,017.93**
Income taxes	-543.00	-711.00	-1,809.00	-2,056.71	-2,634.09	-3,350.90
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-330.00	-124.00	-635.00	-698.50	-768.35	-806.77
Net result after minorities	**45,313.00**	**51,278.00**	**33,336.00**	**38,379.05**	**49,279.28**	**62,860.27**

Balance Sheet	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS, HUF mn, 31/12)						
Intangible assets	3,726.00	6,049.00	11,639.00	8,739.53	10,065.40	11,224.60
Tangible assets	122,780.00	136,049.00	144,863.00	148,707.00	152,857.00	156,257.00
Financial assets	13,611.00	18,579.00	18,985.00	19,934.25	20,930.96	22,557.30
Total fixed assets	**140,117.00**	**160,677.00**	**175,487.00**	**177,380.78**	**183,853.36**	**190,038.90**
Inventories	47,327.00	52,716.00	52,874.00	56,686.24	63,604.19	73,187.50
Receivables and other current assets	38,054.00	53,272.00	64,371.00	70,152.79	80,083.57	92,809.72
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	52,082.00	59,119.00	55,231.00	70,846.39	87,608.99	110,209.75
Total current assets	**137,463.00**	**165,107.00**	**172,476.00**	**197,685.42**	**231,296.75**	**276,206.97**
TOTAL ASSETS	**277,580.00**	**325,784.00**	**347,963.00**	**375,066.20**	**415,150.11**	**466,245.87**
Shareholders'equity	**246,540.00**	**288,115.00**	**306,183.00**	**336,080.82**	**372,313.86**	**419,332.26**
Minorities	**6,486.00**	**5,813.00**	**8,198.00**	**8,484.93**	**8,697.05**	**8,827.51**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	0.00	0.00	0.00	0.00	0.00	0.00
Other LT provisions	0.00	0.00	0.00	0.00	0.00	0.00
Interest-bearing LT debts	403.00	710.00	463.00	393.55	373.87	349.57
Other LT liabilities	71.00	1,775.00	1,249.00	1,280.23	1,299.43	1,318.92
Total long-term liabilities	**474.00**	**2,485.00**	**1,712.00**	**1,673.78**	**1,673.30**	**1,668.49**
Interest-bearing ST debts	118.00	184.00	392.00	397.88	403.85	409.91
Other ST liabilities	23,962.00	29,187.00	31,478.00	28,428.80	32,062.05	36,007.71
Total short-term liabilities	**24,080.00**	**29,371.00**	**31,870.00**	**28,826.68**	**32,465.90**	**36,417.61**
TOTAL LIAB. , EQUITY	**277,580.00**	**325,784.00**	**347,963.00**	**375,066.20**	**415,150.11**	**466,245.87**

Cash Flow Statement	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
(IAS,HUF mn, 31/12)						
Cash flow from operating activities	43,124.00	55,501.00	47,001.00	52,834.17	58,017.08	68,383.01
Cash flow from investing activities	-17,800.00	-24,150.00	-30,196.00	-26,032.32	-28,194.53	-29,922.14
Cash flow from financing activities	-11,990.00	-12,644.00	-18,137.00	-11,246.06	-13,059.95	-15,860.11
CHANGE IN CASH , CASH EQU.	**7,307.00**	**18,057.00**	**-1,377.00**	**15,615.39**	**16,762.60**	**22,600.76**

Margins & Ratios	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Sales growth	nm	21.3%	7.0%	7.3%	16.3%	18.0%
EBITDA margin	32.5%	32.6%	25.2%	26.1%	26.5%	27.2%
EBIT margin	22.9%	23.7%	16.2%	17.4%	18.1%	19.4%
Net profit margin	26.4%	24.6%	15.2%	16.3%	17.9%	19.3%
ROE	36.8%	19.2%	11.2%	12.0%	13.9%	15.9%
ROCE	42.6%	22.3%	12.6%	14.1%	17.0%	20.0%
Equity ratio	91.2%	90.2%	90.3%	91.9%	91.8%	91.8%
Net debt	-51,561.0	-58,225.0	-54,376.0	-70,055.0	-86,831.3	-109,450.3
Working capital	113,383.0	135,736.0	140,606.0	168,858.7	198,830.8	239,789.4
Capital employed	201,536.0	237,478.0	261,254.0	275,791.0	295,479.1	320,028.4
Inventory turnover	3.2	1.8	2.0	2.0	2.1	2.1

Source: Company data, Erste Group estimates

Zentiva from Accumulate to Hold

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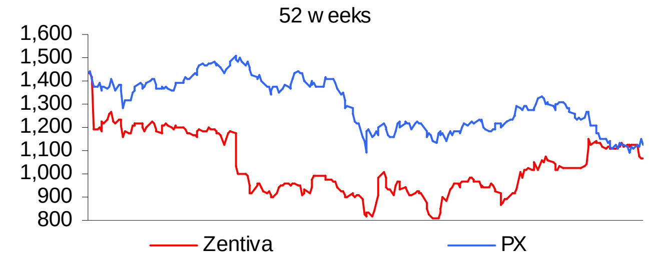
CZK mn	2007	2008e	2009e	2010e
Net sales	16,670.3	19,186.8	21,918.4	24,619.9
EBITDA	3,557.4	4,732.8	5,920.6	7,221.4
EBIT	2,169.6	3,132.2	4,220.0	5,320.8
Net result after min.	1,412.4	1,750.0	2,607.1	3,395.8
EPS (CZK)	37.0	45.9	68.4	89.0
CEPS (CZK)	73.4	87.9	113.0	138.9
BVPS (CZK)	286.4	324.1	383.0	458.0
Div./share (CZK)	8.0	9.5	14.0	20.0
EV/EBITDA (x)	14.8	11.3	8.9	7.1
P/E (x)	26.2	23.2	15.6	12.0
P/CE (x)	13.2	12.1	9.4	7.7
Dividend Yield	0.8%	0.9%	1.3%	1.9%



Performance	12M	6M	3M	1M
in CZK	-25.6%	27.6%	19.9%	-6.3%
in EUR	-11.6%	39.0%	27.0%	-4.8%

Share price (CZK)	1065.00	Reuters	ZNTVsp.PR	Free float	44.7%
Number of shares (mn)	38.1	Bloomberg	ZEN CP	Shareholders	Sanofi-Aventis (24.9%)
Market capitalization (CZK mn / EUR mn)	40,615 / 1,714	Div. Ex-date	07/07/08		PPF Investment Group (19.2%)
Enterprise value (CZK mn / EUR mn)	52,676 / 1,981	**Target price**	**1,155.0**	Homepage:	www.zentiva.cz

Nascent takeover story dictates potential of stock

– **Our new DCF-derived 12-month target price of CZK 1,155 per share is only slightly above our earlier target of CZK 1,120. While our fundamentally-based approach indicates that the stock is fully valued now, a comparative analysis (applying regional pharma M&A deal parameters) points to a possibly higher takeover price of around CZK 1,300 per share. As long as the possible takeover story is hanging in the air, we believe that the stock's potential will largely be determined by moves of the key players in this battle and we recommend that investors stay tuned. All told, we downgrade our recommendation from Accumulate to Hold, with an upward revision possible subject to the nascent takeover story.**

– **We incorporated into our model 1) changes to the reporting structure for sales (from gross to net sales) since the beginning of this year, with resulting changes in absolute sales numbers for individual territories, although we made only a minor downward revision to our overall sales target to CZK 19.2bn; 2) reflecting the more pronounced effect from cost cutting in the area of sales and marketing costs, as well as a less pronounced toll from the Turkish operations, we lift our profitability margin assumptions for 2008, sending our EBIT target to CZK 3,132mn and net profit target to CZK 1,750mn; 3) in line with rising government bond yields, we upped the risk-free rate used in our DCF model from 4.5% to 4.9% for the explicit forecast period 2008-12.**

– **We believe that forward progress is in the cards and that Zentiva's export-driven growth story (potentially to be buoyed by more acquisitions in the future) is largely untouched, while its fundamentals remain very sound, despite the temporary difficulties. We expect the 2Q2008 figures to confirm that the company is on a recovery path (although more is still envisaged to come only in 2H2008). Zentiva's preliminary 1H2008 sales highlights provide clear evidence of this, showing a 32% y/y sales rise to CZK 8.9bn, out of which CZK 2.6bn was contributed by the Turkish arm.**

Changes in forecast/outlook

We project 15.1% y/y top line growth in 2008, driven by acquisitions

While the organic growth tempo is expected to remain subdued, enjoying a boost from the Eczacibasi Generic Pharmaceuticals consolidation, Zentiva has all prerequisites to achieve solid double-digit growth in 2008. With 1H2008 sales results broadly in line with our expectations, our adjustments focus - apart from factoring in the negative impact from the strong CZK – on the incorporation of changes in the reporting structure, shifting from gross to net sales figures per territory as of the beginning of this year. We envisage sales in the Czech market declining by some 7% y/y. With respect to the above-mentioned change, this translates into a new sales target of CZK 4.25bn for 2008. Zentiva's sales in Poland are also anticipated to slow down this year to some CZK 2.1bn, corresponding to a 2% y/y rise. Similarly to its peers, Zentiva's 2008 sales in Russia are expected to witness a strong market revival, driven by the private market. Consequently, we believe that our 2008 target of CZK 1.5bn sales there is realistic. (Contrary to its peers Richter and Krka, Zentiva did not switch to invoicing in euro terms in Russia, deeming the local currency terms as sufficiently safe protection against the US dollar weakening.) While receivables collection has been improving in the past quarters, sales in Romania are anticipated to show a more pronounced recovery only in the second half of 2008; our sales target is CZK 1.6bn for 2008, corresponding to a 6% y/y drop. While the relative strength of the Turkish currency remains important, the shift to modern treatments in primary care bodes well for sustaining a double-digit tempo of Zentiva's sales in Turkey in the coming period. Consequently, we forecast Eczacibasi Generic Pharmaceuticals' contribution to Zentiva's exports in 2008 at around CZK 5.5bn (including contractual manufacturing business). In summary, our forecast for Zentiva's 2008 consolidated sales arrives at CZK 19.2bn, down from the earlier projected CZK 19.9bn. For 2009, we lower our sales target from CZK 23.0bn to CZK 21.9bn.

Reflecting strong CZK impact, we revise our sales target for 2008 to CZK 19.2bn

Summary of changes to 2008 and 2009 forecasts

CZK mn	2008 orig. forecast		2008 new forecast		2009 orig. forecast		2009 new forecast	
Sales	**19,923.2**	**100.0%**	**19,186.8**	**100.0%**	**23,002.4**	**100.0%**	**21,918.4**	**100.0%**
CGS	8,527.2	42.8%	8,053.7	42.0%	9,008.3	39.2%	**8,602.3**	39.2%
Gross profit	**11,396.0**	**57.2%**	**11,133.1**	**58.0%**	**13,994.1**	**60.8%**	**13,316.1**	**60.8%**
Sales and marketing costs	5,439.0	27.3%	5,046.1	26.3%	6,210.7	27.0%	5,764.5	26.3%
General &admin. costs	2,211.5	11.1%	2,129.7	11.1%	2,530.3	11.0%	2,411.0	11.0%
R&D	777.0	3.9%	825.0	4.3%	908.6	4.0%	920.6	4.2%
EBIT	**2,968.5**	**14.9%**	3,132.2	**16.3%**	**4,344.6**	**18.9%**	**4,220.0**	**19.3%**
Fin result	-426.0	-2.1%	-584.6	-3.0%	-409.2	-1.8%	-488.8	-2.2%
Pre-tax profit	**2,542.5**	**12.8%**	2,547.6	**13.3%**	**3,935.5**	**17.1%**	**3,731.2**	**17.0%**
Tax	737.3	3.7%	738.8	3.9%	1,082.3	4.7%	1,026.1	4.7%
Minorities	-55.0	-0.3%	-58.8	-0.3%	-94.8	-0.4%	-98.0	-0.4%
Net profit after minorities	**1,750.2**	**8.8%**	1,750.0	**9.1%**	**2,758.4**	**12.0%**	**2,607.1**	**11.9%**

Source: Erste Group estimates

We envisage somewhat smaller margin compromise on EBIT level

The 2008 interim results are anticipated to demonstrate uneven quarterly performance in the Turkish operations, as well as the dilutive impact of the Eczacibasi Generic Pharmaceuticals consolidation. With respect to the better than expected 1Q08 profitability data, we opt to cautiously raise our 2008 gross margin target to 58.0% (up from the 57.2% projected earlier). Also, the operating profit margin was (thanks to a bold cost cutting move in the area of sales and marketing costs) above our assumptions. We assume more savings in the future, which prompts us to reduce our sales and marketing cost forecast further, from 27.3% to 26.3% of total 2008 sales. Reflecting the lower than anticipated administrative and general costs burden, we cut this item to CZK 2,130mn, or 11.1% of sales in 2008. All told, our new 2008 operating profit target arrives at CZK 3,132mn (vs. the CZK 2,968mn projected earlier), translating into an EBIT margin of 16.3% (vs. 14.9% in our earlier projections).

...and stick to our bottom line target at CZK 1,750mn for 2008

As our previous forecast already incorporated the impact of the post-closing adjustment of EUR 58mn for the Turkish acquisition (lowering the company's debt, with a resulting reduction in interest expense on one side, but also bringing negative forex charges, due to the appreciating CZK vs. euro), we remain on the conservative side and based on slightly worse 1Q result we adjust our target for the 2008 financial result from a CZK 426mn loss to a CZK 584.6mn loss. All told, we leave our 2008 net profit target unchanged at CZK 1,750mn.

1H2008 results preview

Although the buoying effect from the consolidation of Eczacibasi Generic Pharmaceuticals was partly mitigated by unfavorable currency developments (namely the strengthening of the CZK vs. the euro and Turkish lira), according to the recently published management estimates, Zentiva's sales tempo reached 32% y/y, bringing its consolidated sales to CZK 8.9bn (including CZK 2.6bn from Turkey) in 1H2008. In the second quarter alone, the company posted sales of around CZK 4.5bn. As the company already announced its 1H2008 sales highlights, the full report is not anticipated to bring any major surprises on the top line, only more details on the company's performance in its key markets. Attention will concentrate on the pace of the integration of the recently acquired Turkish business, as well as how the company is weathering the still challenging conditions in its home market and Romania. While the weaker profitability parameters of Eczacibasi will continue to bite into Zentiva's operating margin in 2Q2008, the company's cost containment measures (particularly in the area of sales and marketing costs) should provide at least a partial antidote. While we cannot rule out needs for provisioning and write-offs, we believe that the previous year period's low comparative base (plagued by Romanian business related write-offs and provisioning) provides sufficient room for solid y/y growth. We expect the 2Q2008 operating profit to rise by a hefty 110.3% y/y to CZK 735.9mn, sending the 1H2008 EBIT to CZK 1,545.5mn. Nevertheless, given the y/y increasing financial leverage linked to the Turkish acquisition, the tempo on the bottom line is expected to be tempered to 27.8% y/y (to CZK 399.2mn). In summary, our 1H2008 net profit target arrives at CZK 868.9mn, up 4.5% y/y.

1H2008 results preview

IFRS consolidated	2Q 2008e	2Q 2007	y/y	1H2008e	1H2007	y/y
Total sales (CZK mn)	4,558.0	3,418.9	*33.3%*	8,937.0	6,796.6	*31.5%*
Operating profit (CZK mn)	735.9	349.9	*110.3%*	1,545.5	1,110.1	*39.2%*
Net income (CZK mn)	399.2	312.4	*27.8%*	868.9	831.3	*4.5%*
Operating margin	*16.1%*	*10.2%*		*17.3%*	*16.3%*	
Net margin	*8.8%*	*9.1%*		*9.7%*	*12.2%*	

Source: Erste Group Research, Company data

Valuation summary

Bond yields higher…

…prompting us to adjust our DCF model parameters

With the CZK reaching new record highs vs. the euro and bond yields on the rise, we are forced to adequately adjust the macroeconomic assumptions included in our model. The strong CZK impact is largely mitigated by the company's policy of invoicing in local currencies (which, similarly to the CZK, are experiencing a period of appreciation in most of its CEE markets), as well as by the natural hedge provide by its local manufacturing operations in countries with not so strong local currency developments (Romania, Turkey). Thus, the major adjustment, apart from the shifting timeframe in our model, is an increase in the risk-free rate assumptions from 4.5% to 4.9% for the explicit forecast period 2008-12. Our new DCF-derived 12-month target price arrives at CZK 1,155 per share, up marginally from the CZK 1,120 per share targeted earlier.

Nascent takeover story provides solid backup for Zentiva share price

The 2008 interim reports should further ease worries about the health of the Romanian business and demonstrate the beneficial impact of cost savings in the area of sales and marketing on margins. The figures should also provide evidence that Zentiva's consolidation of its Turkish arm is bringing rewards. However, investor attention is likely to focus on developments around the possible takeover of the company. On May 2, 2008, Czech investment group PPF (acting in concert with PPF Generali Holding) announced a CZK 950 per share bid for Zentiva, valuing the Czech generics manufacturer at CZK 36.2bn. The offer, made via subsidiary Anthiarose Ltd, lost its appeal as soon as Sanofi-Aventis (with a 24.9% stake the largest single shareholder in Zentiva) said that it is ready to make a cash bid for Zentiva at CZK 1,050 per share (valuing Zentiva at around EUR 1.66bn, 10.5% above PPF's bid). (For comparison, Sanofi-Aventis paid around EUR 45 per Zentiva share in March 2006, when it purchased its 24.9% stake in the company from Warburg Pincus and the company's management.)

Free cash flow forecast

CZK mn	2008e	2009e	2010e	2011e	2012e
EBIT	3,132.2	4,220.0	5,320.8	6,021.0	6,650.4
Depreciation	1,600.6	1,700.6	1,900.6	2,000.6	2,100.6
EBITDA	4,732.8	5,920.6	7,221.4	8,021.6	8,751.0
Investments	659.1	-1,558.1	-1,786.5	-1,963.0	-2,113.6
Change in working capital	-848.0	-1,144.6	-1,289.0	-1,299.8	-1,372.6
Corporate income taxes	738.8	1,026.1	1,308.4	1,512.6	1,692.5
Free cash flow	3,805.1	2,191.8	2,837.5	3,246.2	3,572.2

DCF valuation

Key parameters of DCF valuation

	08-12e	perpetuity		
			PV of the FCF (CZK mn)	13,266
beta	0.84	1.0	PV of TV (CZK mn)	37,990
risk free rate (%)	4.9%	5.0%	Total value of the company (CZK mn)	51,256
market premium (%)	5.5%	5.5%	-net debt (CZK mn)	-14,570
WACC (%)	8.9%	10.1%	Value of the equity (CZK mn)	36,686
perpetuity cash flow growth rate (%)		4.0%	Equity value per share (CZK) as of 31.12. 2007	962
			Equity value per share (CZK) as of 31.7. 2009	1,155

Equity value per share (CZK) as of 31.7. 2009

		Discount rate				
		8.75%	9.25%	9.75%	10.25%	10.75%
Perpetuity cash flow growth rate	3.0%	1,246	1,113	1,000	902	817
	3.5%	1,369	1,214	1,083	973	878
	4.0%	1,517	1,333	1,182	1,055	946
	4.5%	1,700	1,478	1,299	1,151	1,027
	5.0%	1,932	1,657	1,440	1,265	1,120

Source: Erste Group Research

With respect to our 12-month target price of CZK 1,155 per share, we downgrade to Hold…

Possible bidding war could raise our target price to some CZK 1,300per share

After PPF announced its intention to withdraw its bid on July 22, for Zentiva's share price developments in the coming weeks, the crucial issue will be the willingness of Sanofi–Aventis to stick to the bid and/or the possibility of an eventual bidding war with eventual newly emerging counterofferor (similar to the one we witnessed during the Pliva takeover). While Sanofi–Aventis' bid (currently valid until September 19, 2008) has practically made PPF's original bid unattractive, it is still not clear that it will succeed (as it is conditional last but not least upon receiving more than 50% of shares in Zentiva). All told, we recommend that investors monitor the situation closely before taking any action. Furthermore, we continue to believe that neither the PPF nor Sanofi–Aventis offer reflect Zentiva's fundamentals, to say nothing of any premium for majority control over the company. A brief look at past transactions in the region suggests that a price closer to CZK 1,300 per Zentiva share would be more adequate, in our opinion (translating into 2008e P/sales of 2.6 and 2008e EV/EBITDA of 13.0). (For example, Zentiva's Eczacibasi Generics Pharmaceutical acquisition multiples stood at P/Sales of 3.1 and EV/EBITDA of 13.0; Barr Pharmaceuticals' acquisition of Pliva took place at P/Sales of 2.4, while the original offer by Activis was done at P/Sales of 1.7). Our revised fundamentally-based DCF model points to a 12-month target price of CZK 1,155 per share (vs. the earlier CZK 1,120 per share). Consequently, we reduce our recommendation on the stock from Accumulate to Hold. Nevertheless, an upgrade is pending, should a takeover battle be ignited, with a new possible target price currently seen at around CZK 1,300.

Selected M&A deals in the region

Company	Stake acquired (%)	Price (USD mn)	Purchaser	P/E	P/Sales
Lek	100.0%	877.8	Novartis	24.8	2.6
Polfa Poznan	80.0%	220.0	Glaxo Wellcome	17.4	2.7
Sicomed	74.9%	149.8	Zentiva	34.3	2.7
Sindan	100.0%	178.4	Actavis	n.a	2.2
Pliva*	100.0%	1,600	Actavis	19.8	1.7
Pliva**	100.0%	1,850	Actavis	22.3	1.9
Pliva***	100.0%	2,200	Barr Pharmaceuticals	25.5	2.1
Pliva****	100.0%	2,585	Barr Pharmaceuticals	29.1	2.4
Terapia	96.7%	324.0	Ranbaxy	n.a.	4.1
Eczacibasi	75.0%	594.0	Zentiva	37.4	3.1
Zentiva	24.9%	514.7	Sanofi -Aventis	22.5	3.5
Hemofarm	100.0%	619.6	Stada	18.1	2.4
Polpharma*	99.65%	1,337.0	Richter Gedeon	n.a.	3.0
Akrikhin*	80.62%	128.0	Richter Gedeon	n.a.	2.0
Zentiva*	100.0%	2,661.7	Sanofi -Aventis	22.9	2.1

Source: Erste Group Research
Lek based on 2001 data, Terapia based on 2005 pro-forma results
Sicomed's ratios based on Sicomed's 2005 actual results
Pliva* - original Actavis' bid (HRK 570 per share)
Pliva** - upped Actavis' bid from April 2006 (HRK 630 per share)
Pliva*** - Barr's bid from June 2006 (HRK 705 per share)
Pliva**** - Barr's public tender offer (HRK 820 per share)
Please note that the actual acquired stake amounted to 91.75%, we leave 100% here for comparative purpose with Actavis bid
Polpharma* and Akrikhin* P/sales ratios based on expected 2007 sales; due to corporate governance issues the transaction did not take place
Zentiva* - Sanofi-Aventis bid from July 2008

Income Statement (IAS, CZK mn, 31/12)	**2005** 31/12/2005	**2006** 31/12/2006	**2007** 31/12/2007	**2008e** 31/12/2008	**2009e** 31/12/2009	**2010e** 31/12/2010
Net sales	**11,839.35**	**14,003.13**	**16,670.32**	**19,186.82**	**21,918.36**	**24,619.90**
Cost of goods sold	-4,544.00	-4,940.51	-6,877.06	-8,053.72	-8,602.27	-9,131.10
Gross profit	**7,295.36**	**9,062.62**	**9,793.26**	**11,133.10**	**13,316.09**	**15,488.80**
SG&A	-4,224.61	-5,203.52	-6,935.73	-7,175.87	-8,175.55	-9,158.60
Other operating revenues	0.00	0.00	0.00	0.00	0.00	0.00
Other operating expenses	-492.46	-556.00	-687.88	-825.03	-920.57	-1,009.42
EBITDA	**3,243.24**	**4,172.78**	**3,557.44**	**4,732.78**	**5,920.55**	**7,221.36**
Depreciation/amortization	-664.95	-869.68	-1,387.80	-1,600.58	-1,700.58	-1,900.58
EBIT	**2,578.29**	**3,303.10**	**2,169.64**	**3,132.20**	**4,219.97**	**5,320.78**
Financial result	91.49	-213.79	-197.94	-584.56	-488.77	-474.83
Extraordinary result	0.00	0.00	0.00	0.00	0.00	0.00
EBT	**2,669.77**	**3,089.31**	**1,971.70**	**2,547.64**	**3,731.20**	**4,845.95**
Income taxes	-741.16	-800.03	-515.47	-738.81	-1,026.08	-1,308.41
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-51.08	-86.12	-43.80	-58.81	-97.97	-141.74
Net result after minorities	**1,877.54**	**2,203.16**	**1,412.43**	**1,750.01**	**2,607.15**	**3,395.80**

Balance Sheet (IAS, CZK mn, 31/12)	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Intangible assets	2,946.12	2,717.03	13,874.17	13,871.58	12,971.00	12,070.42
Tangible assets	5,578.52	5,960.07	8,643.80	8,325.81	12,075.81	13,825.81
Financial assets	178.94	269.10	279.94	356.92	455.08	580.22
Total fixed assets	**8,703.58**	**8,946.19**	**22,797.90**	**22,554.31**	**25,501.88**	**26,476.45**
Inventories	2,249.01	2,410.35	3,000.89	3,367.54	3,791.19	4,256.34
Receivables and other current assets	4,853.76	5,721.43	8,927.87	8,284.20	9,357.88	10,530.56
Other assets	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents	3,223.39	1,189.50	2,227.58	2,887.43	3,205.00	3,889.63
Total current assets	**10,326.15**	**9,321.28**	**14,156.34**	**14,539.18**	**16,354.06**	**18,676.52**
TOTAL ASSETS	**19,029.73**	**18,267.47**	**36,954.25**	**37,093.49**	**41,855.95**	**45,152.97**
Shareholders'equity	**9,064.09**	**11,028.55**	**10,921.80**	**12,359.58**	**14,604.43**	**17,466.33**
Minorities	**717.46**	**1,068.35**	**1,037.61**	**1,073.92**	**1,100.77**	**1,117.28**
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	2,072.94	0.00	13,145.07	11,173.31	10,614.64	9,924.69
Other LT liabilities	355.21	280.88	5,077.56	5,204.49	5,282.56	5,361.80
Total long-term liabilities	**2,428.15**	**280.88**	**18,222.63**	**16,377.81**	**15,897.21**	**15,286.49**
Interest-bearing ST debts	3,100.17	3,709.35	3,652.78	3,707.57	3,763.18	3,819.63
Other ST liabilities	3,719.86	2,180.34	3,119.44	3,574.62	6,490.36	7,463.24
Total short-term liabilities	**6,820.03**	**5,889.69**	**6,772.22**	**7,282.18**	**10,253.54**	**11,282.86**
TOTAL LIAB. , EQUITY	**19,029.73**	**18,267.47**	**36,954.25**	**37,093.49**	**41,855.95**	**45,152.97**

Cash Flow Statement (IAS,CZK mn, 31/12)	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Cash flow from operating activities	2,122.82	1,541.05	2,734.18	2,163.20	2,741.00	3,638.57
Cash flow from investing activities	-3,467.75	-1,621.94	-14,236.33	659.11	-1,558.09	-1,786.53
Cash flow from financing activities	4,241.76	-2,028.41	12,660.26	-2,222.06	-865.35	-1,167.41
CHANGE IN CASH , CASH EQU.	**2,753.01**	**-2,033.89**	**1,038.09**	**659.85**	**317.56**	**684.63**

Margins & Ratios	**2005**	**2006**	**2007**	**2008e**	**2009e**	**2010e**
Sales growth	nm	18.3%	19.0%	15.1%	14.2%	12.3%
EBITDA margin	27.4%	29.8%	21.3%	24.7%	27.0%	29.3%
EBIT margin	21.8%	23.6%	13.0%	16.3%	19.3%	21.6%
Net profit margin	16.3%	16.3%	8.7%	9.4%	12.3%	14.4%
ROE	41.4%	21.9%	12.9%	15.0%	19.3%	21.2%
ROCE	32.1%	17.5%	7.8%	7.5%	10.0%	12.0%
Equity ratio	51.4%	66.2%	32.4%	36.2%	37.5%	41.2%
Net debt	1,949.7	2,519.9	14,570.3	11,993.4	11,172.8	9,854.7
Working capital	3,506.1	3,431.6	7,384.1	7,257.0	6,100.5	7,393.7
Capital employed	12,086.5	14,897.6	31,607.2	30,631.4	32,160.6	33,800.1
Inventory turnover	4.0	2.1	2.5	2.5	2.4	2.3

Source: Company data, Erste Group estimates

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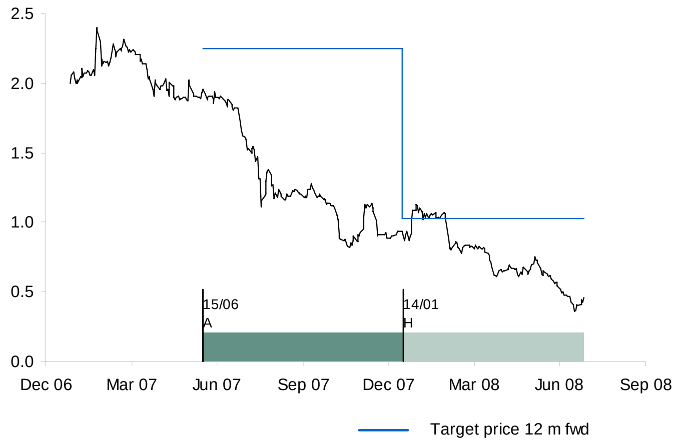
Alexandra Blach	+43 (0)5 0100 - 84141
Markus Pistracher	+43 (0)5 0100 - 84100
Roman Friesacher	+43 (0)5 0100 - 84143
Helmut Kirchner	+43 (0)5 0100 - 84144
Christian Skopek	+43 (0)5 0100 - 84146
Fixed Income Institutional Desk	
Head: Thomas Almen	+43 (0)5 0100 - 84323
Martina Fux	+43 (0)5 0100 - 84113
Michael Konczer	+43 (0)5 0100 - 84121
Ingo Lusch	+43 (0)5 0100 - 84111
Lukas Linsbichler	+43 (0)5 0100 - 84345
Karin Rauscher	+43 (0)5 0100 - 84112
Michael Schmotz	+43 (0)5 0100 - 84114

Bioton

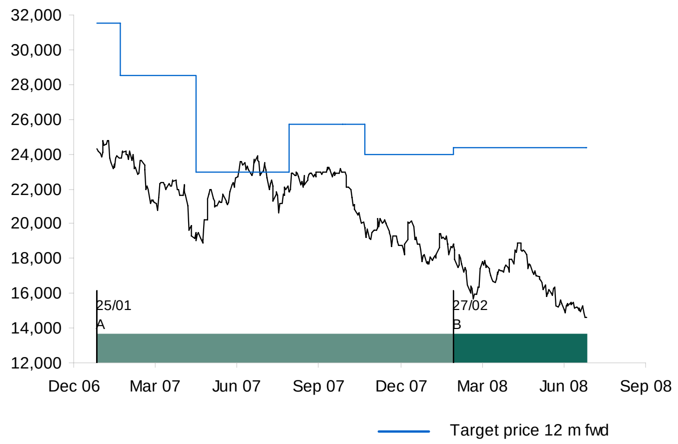


Rating history

Date	Rating	Price	Target Price
14. Jan 08	Hold	0.94	1.03
15. Jun 07	Accumulate	1.96	2.25

Company	Disclosure
Bioton	

Egis

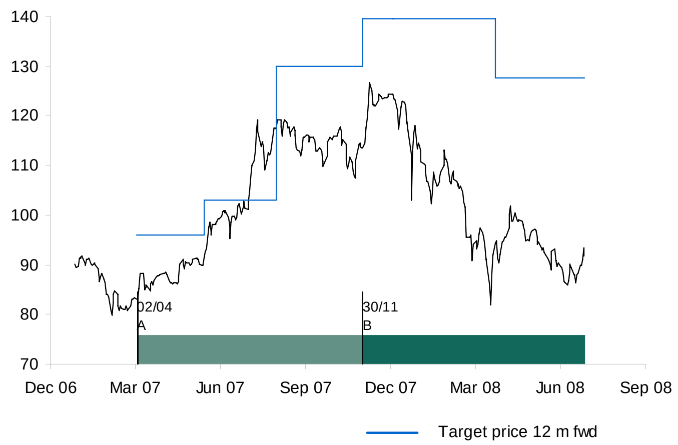


Rating history

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

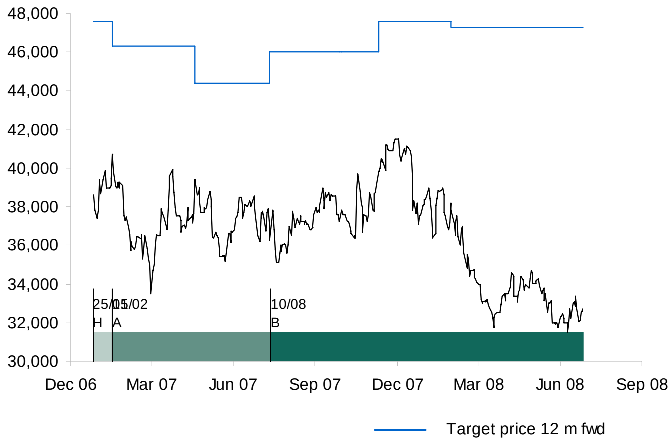


Rating history

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

Company	Disclosure
Krka	

Richter Gedeon

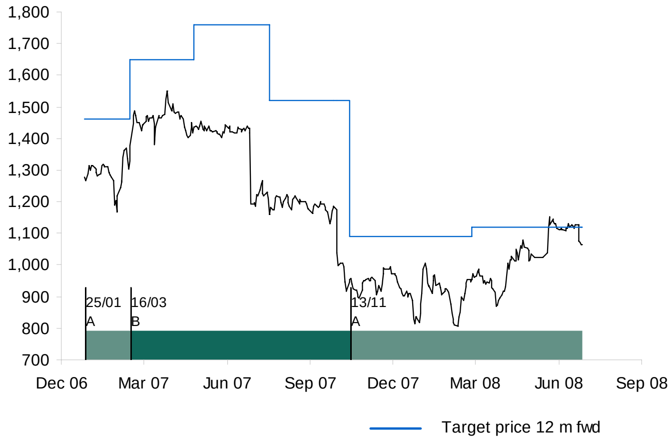


Rating history

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	

Zentiva



Rating history

Date	Rating	Price	Target Price
13. Nov 07	Accumulate	955.50	1090.00
16. Mar 07	Buy	1376.00	1650.00
07. Nov 06	Accumulate	1285.00	1460.00
30. Jun 06	Buy	1068.00	1420.00
05. Oct 05	Accumulate	1146.00	1270.00
01. Sep 05	Hold	940.30	933.00
10. May 05	Accumulate	766.50	940.00
11. Mar 05	Hold	928.00	940.00
09. Nov 04	Accumulate	652.20	688.00
19. Aug 04	Buy	548.70	630.00

Company	Disclosure
Zentiva	2, 4

Important Disclosures

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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.

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