

CEE pharmaceutical companies see healthy prospects in the year ahead

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- CEE pharma stocks spared from the worst of the crisis, due to their defensive nature and solid outlook
- Pharmaceutical markets' prospects left largely intact by the financial crisis, with generics poised to see their appeal rise
- Krka and Richter continue to top recommendation list, followed by Egis

Reflecting the mounting crisis in the financial sector and its impact on global economic growth, stock markets around the globe tumbled last year, finishing at record lows. Although equity markets are prone to remain volatile, Erste Group analysts highlight that the sentiment is slightly recovering and investors start to separate the wheat from the chaff. "The CEE pharma leaders, with their still healthy prospects and sound balance sheets, should be among the first stocks poised to return to investors' favor" states Vladimíra Urbánková, pharma sector analyst at Erste Group.



The panic run from equities led to a massive selling wave across the board in 2008, and wiped out all the previous periods' gains for CEE pharma stocks. For most of the year, investors tended to largely ignore fundamental news, including the 2008 interim performance data. Even stocks with untouched fundamentals like Krka failed to translate their excellent business performance into decent share price developments and dived deeper and deeper to new lows. Nevertheless, the fall in prices slowed down before the end of the year, indicating that the defensive nature of the pharma industry finally started to play in their favor.

While CEE markets will also witness a slowdown of their economic tempo, Erste Group analysts point out that the impact on the pharmaceutical business should be limited. First of all, the external indebtedness of CEE pharma companies remains minimal, as they can finance their investment plans without tapping financial markets.

Consequently, they are not negatively hit by the currently tightening availability of credit resources. Secondly, since Erste Group's last sector report (in October 2008), regional currencies continued their weakening trend, to the benefit of export-oriented CEE pharmas.

Although a lid on growth was felt in certain markets (Ukraine and Russia), CEE pharma companies' balance sheets remain healthy, with a solid cash pile. Generics will keep their status as drugs of choice in CEE countries and will get even stronger preference than before in the West. As Erste Group analysts show, generic drug consumption is poised to rise even during a crisis, as cheaper generic drugs will further increase their appeal to ever-more cost-conscious health insurers, both in the East and in the West. Finally, despite the slowing economic growth, the CEE pharmaceutical markets are set to rise, narrowing the gap in healthcare (and drug) spending between the CEE region and the EU-15 average in the long run.

"In our opinion, the top CEE pharmas continue to represent a sound long-term investment, with the scope of negative surprises minimized due to the high degree of crisis resilience of their generics business model" Urbánková points out. CEE pharma leaders' balance sheets remain solid and, although the tighter liquidity situation

is likely to prompt them to rethink their bigger acquisition plans (should they be financed with external loans), regular investment activities and even small acquisitions are still easily accomplished.

Company	Currency	Current Price (LC)	Year high (LC)	Current price vs YH (%)	Target price (LC)	Upside potential (%)
Krka	EUR	55.0	116.8	-52.9%	113.0	105.5%
Richter Gedeon	HUF	28,055	39,350	-28.7%	40,550	44.5%
Egis	HUF	12,195	19,800	-38.4%	20,560	68.6%
Zentiva	CZK	1,118	1,174	-4.8%	1,150	2.9%
Bioton	PLN	0.20	1.14	-82.5%	0.19	-5.0%

Based on closing prices as of January 27, 2009; Source: Erste Group Research

- With the drug pricing pressures in Hungary gradually easing and exports to be further bolstered by favorable currency developments, Hungarian pharma companies should see solid top line growth in the coming period. Reflecting the somewhat stabilizing situation in the Hungarian financial market compared to autumn 2008 (when bond yields peaked), Erste Group analysts slightly reduce the risk-free rate assumptions in the DCF models for the Hungarian pharmas. All told, analysts raise target prices for Richter and Egis to HUF 40,550 per share and HUF 20,560 per share, respectively. They highlight, that all risks are more than fully factored in to the still depressed stock prices and reiterate Buy recommendations for both Richter and Egis.
- The takeover story provided a safe anchor to Prague-based Zentiva's share price. Sanofi-Aventis' raised bid at CZK 1,150 - accepted earlier by Zentiva's management - was prolonged until February 20, 2009. Given the current market turbulence, with the stock prices of Zentiva's peers plummeting to new lows in the past weeks, analysts do not anticipate that the takeover premium for Zentiva would reach highs comparable to past transactions in the sector. Consequently, Erste Group analysts opt to adjust their target price to CZK 1,150 per share (corresponding to Sanofi-Aventis' bid, which dictates the market ceiling at the moment) and stick to Hold. While the buildup of positions by PPF Group and other financial investors might indicate some probability of pressure on Sanofi-Aventis to raise its offer, accepting the Sanofi-Aventis bid remains the safest exit scenario for investors
- Although Krka managed to beat its regional peers once again with its excellent 1-3Q2008 results (delivering double-digit progress on the top and bottom lines), the company's share price came under selling pressure before the end of 2008, and only recently recovered partially from its slump. The recent preliminary 2008 sales report (consolidated sales up 22% y/y to EUR 950mn) sent another positive signal and we anticipate that Krka's 2008 full results (due on February 26) will confirm the company's regional competitive edge. Erste Group analysts' revised target price of EUR 113.0 per share suggests that the stock's upside potential from the currently depressed levels is very attractive, especially should the stock regain its earlier valuation premium to its peers later this year. Analysts stick to their Buy recommendation.

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