With solid prospects largely immune to financial crisis, CEE pharmas are critical for investment portfolios this year

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- CEE pharma companies' generics model and healthy balance sheets point to still solid growth prospects
- CEE pharma stocks remain an attractive option for long-term, value-based investments
- Richter and Krka are top picks, Egis' valuation gap still attractive

While the general economic outlook is still gloomy and market participants have to digest steady news on downgrading and slashing of economic growth forecasts (including those for key markets of CEE pharma players), the impact on the pharmaceutical business should be rather limited. “CEE pharma companies' growth prospects are still solid due to their healthy balance sheets, with a hefty cash pile, and to the sound generics model,” states Vladimíra Urbánková, pharma sector analyst at Erste Group. Mergers and acquisitions activity in the sector reached new highs recently, with generics seen as a welcome addition to business portfolios of original drug manufacturers. All of this should bode well for pharma stocks' performance in the coming period.

Even as the growth tempo in CEE is subduing due to the world economic crisis, several specific factors will help CEE-based pharma companies mitigate the negative consequences. First of all, the ageing population and broader availability of more modern therapies are still strongly present. Consequently, despite the slowing economic growth, the CEE pharmaceutical markets are poised to rise, narrowing the gap in healthcare (and drug) spending between the CEE region and the EU-15 average in the long run. Secondly, lower inflationary pressures in CEE countries will bring down commodity prices and temper the rise in personnel costs, as well as other operating expenses (energy, services, etc.). Thirdly, the external indebtedness of CEE pharma companies remains minimal and they can finance their investment plans without tapping financial markets. Consequently, they are not negatively hit by the currently tightening availability of credit resources.

The main challenge comes from the currency side, with a lid on sales growth palpable particularly in countries with sharply weakening currencies (Ukraine and Russia). Nevertheless, export-oriented CEE-based pharmas such as the Hungarian ones are supported by their home currencies depreciation and should see sound top line growth.

Overall, the CEE equity markets are not poised for an immediate recovery, as the ailing economic fundamentals will determine market participants to remain cautious. Volatility is likely to continue, and it is exactly this that will be creating interesting trading opportunities. “For those that want to play it safe and keep a longer-term horizon in mind, the top CEE pharmas remain a healthy option,” Urbankova also explains. Erste Group analysts continue to believe that the top CEE pharmas represent a sound long-term value-based investment, with a high degree of crisis resilience, due to their generics business model and sound balance sheets. Importantly, in times when savings become an imperative, generics remain preferred in CEE countries and are gaining more appeal in the West.

Valuation summary

01/05/2009 Company	Rep. Curr.	Mcap (EURmn)	Price Current (LC)	Price Target	Recommendation	Performance (EUR terms) 1M	3M	6M	12M
A&D Pharma	EUR	49.0	1.5	2.9	Hold	-26.1%	-26.5%	-41.2%	-79.0%
Bioton	PLN	312.2	0.31	0.28	Reduce	45.8%	56.5%	-36.6%	-62.6%
Egis	HUF	327.5	12,165	19,965	Buy	10.3%	7.3%	7.7%	-40.7%
Intercell	EUR	910.6	20.0	39.5	Buy	-15.3%	-22.1%	-8.3%	-26.5%
Krka	EUR	1,920.8	54.2	105.0	Buy	3.1%	-0.2%	-16.3%	-43.2%
Richter Gedeon	HUF	1,842.6	28,590	38,990	Buy	20.3%	11.1%	-9.2%	-25.3%
Sanochemia	EUR	20.3	2.0	under review	under review	-3.8%	-22.5%	-51.8%	-73.0%
Teva Pharmaceutical	ILS - I	29,728	-	-	-	-2.5%	1.1%	0.4%	9.4%
Mylan Inc.	USD -	2,991	-	-	-	-6.2%	8.6%	39.9%	14.3%
Watson Pharmaceuticals	USD -	2,399	-	-	-	2.5%	6.2%	11.5%	19.0%
Stada Arzmeimittel AG	EUR -	835	-	-	-	8.6%	-26.2%	-44.1%	-68.1%
Ranbaxy Laboratories	INR -	1,081	-	-	-	-6.8%	-21.5%	-23.8%	-66.5%
Recordati	EUR -	912	-	-	-	4.3%	10.3%	2.2%	-7.3%
Dr Reddy Laboratories	INR -	1,397	-	-	-	11.6%	19.5%	28.1%	-17.9%
EuroStoxx Healthcare		109,171	-	-	-	4.4%	-3.3%	-11.4%	-23.4%

Based on closing prices as of May 1, 2009
Source: Erste Group Research, JCF estimates

■ DErste Group analysts adjusted the valuation models for the Hungarian pharmas in order to reflect their new standard methodology for setting equity risk premiums. Thus, they fine-tune the target prices for Richter and Egis to HUF 38,990 per share and HUF 19,955 per share, respectively. Analysts continue to believe that stock price levels are still attractive and reiterate their Buy recommendations for both Richter and Egis.

■ Although Krka continues to outperform its regional peers, the company's share price recovery from its lows remains fragile. While the company lacks the substantial currency cushion enjoyed by its Hungarian rivals in 2009, Krka's sales growth tempo in euro terms, as well as its profitability margins, should stay at the region's (and generics sector) top. Erste Group analysts revised the target price of EUR 105.0 per share. This indicates that the stock's price has yet to capture Krka's competitive edge, especially should the stock regain its earlier valuation premium to its peers later this year. Analysts confirm the Buy recommendation on Krka stock.

■ Despite a very disappointing 2008 report, Bioton's share price moved skywards, propelled by renewed investor hopes that the strategy to be presented by the newly appointed CEO, as well as the capital injection from its key shareholders, will bring the desired turnaround in the company's fortunes. Erste Group analysts adjust the 12-month target price to incorporate the worse than anticipated 2008 results, but also a clearer direction going forward, which yields a new target price of PLN 0.28 per share. Therefore, they stick to the Reduce recommendation on the stock. Further potential upgrade hinges on the company's ability to deliver the first tangible results of its business restructuring.

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