ERSTE GROUP

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CEE pharmas set to regain investors' favour in 2010

- **Having fallen from investors' grace in 2009, CEE pharma stocks are bound to regain their appeal as defensive titles**
- **CEE pharma companies remain poised to deliver solid business results, albeit growth tempo will be lower compared to pre-crisis levels**
- **Richter and Egis are top picks, Krka's depressed share price is inviting**

In 2009, the gradual return of investors' risk appetite generally played in favor of CEE markets. In particular, the region managed to catch up in the second half of 2009 after the previous under-performance, with the emerging equity market funds recording money inflows and trading volumes starting to pick up. Nevertheless, for CEE pharma stocks (as for other defensives), the decreasing risk aversion was bad news. Their tempo lagged behind those of the banks, real estate titles and cyclicals, so much so as to slip into negative territory in 4Q09. Nevertheless, on a cumulative basis, CEE pharmas' stock price performances (except Bioton) for FY09 remained in high double-digit terms.

"Going forward, their defensive nature will play both for and against CEE pharma stocks. For 1Q10, the sentiment is foreseen to favor cyclicals, with investments in pharma titles to be sidelined. However, as economic conditions remain fragile and the impact of the economic slowdown will still be reflecting in cyclicals' business results, we might see a return of investors to defensive titles later in the year. We believe that healthcare - and especially generics players - should then be among the preferred picks," explains Vladimíra Urbánková, pharma sector analyst at Erste Group.

The outlook is rather encouraging: CEE pharma companies can expect growth to be restored in all major regional markets, including those hit hardest last year, such as Ukraine. Bolstered by the appreciating ruble, as well as the recovery of oil prices, the crucial Russian market is getting back on track, further supporting CEE-based pharmas. The low comparative base will also help, especially in the first half of 2010. The CEE region's return to the catch-up effect, coupled with demographic factors (such as ageing populations), an increasing public healthcare awareness and the continual progress in bringing innovative medicines to the market should propel CEE pharma markets in the coming years. While the future economic growth will also spur greater resources available for healthcare, the cost-conscious approach of healthcare providers is unlikely to change. This in turn will put pressure on drug reimbursement policies to be as cost-efficient as possible. On the one side, this speaks in favor of generics producers. On the other hand, the pressure on their price-competitiveness will further intensify.

Erste Group analysts believe that the top CEE pharma companies are poised to deliver solid business results, although - due to the restrictive drug pricing reimbursement measures - the tempo might be somewhat tempered compared to pre-crisis days. Also in 2010, CEE pharma stocks, representing a safe haven in times of turbulences and uncertainty, will undoubtedly continue to be driven by changing investor sentiment (apart from their business results). However, with their current valuations far below their earlier peaks, the top CEE pharma stocks retain their long-term appeal.

Valuation summary:

CEE pharma shares offer attractive upside potential

Company	Recommendation	Currency	Current Price (LC)	1-year-high (LC)	Current price vs 1-y- high (%)	Target price (LC)	Upside potential (%)
Antibiotice	Reduce	RON	0.645	0.800	-19.4%	0.624	-3.2%
Biofarm	Hold	RON	0.211	0.255	-17.6%	0.222	5.1%
Bioton	Hold	PLN	0.20	0.35	-42.9%	0.21	3.4%
Egis	Accumulate	HUF	18,850	21,800	-13.5%	21,755	15.4%
Krka	Buy	EUR	65.8	76.5	-14.0%	92.0	40.0%
Richter Gedeon	Accumulate	HUF	41,200	44,000	-6.4%	48,200	17.0%

Based on closing prices as of February 1, 2010; Source: Erste Group Research

- Unlike in 2009, heavily export-geared Hungarian pharmas cannot rely on the supportive effect from the y/y weaker forint in 2010. On the other hand, the HUF stabilization means that the quarterly volatility of their financial results should diminish. The improving Hungarian macroeconomic picture should bode well for the Hungarian pharmas' valuations. The (at least partial) closing of the valuation gap should propel Egis' share price appreciation, while for Richter the R&D pipeline progress should provide a desirable stock trigger. In summary, the **target prices for Richter and Egis arrive at HUF 48,200 per share and HUF 21,755 per share**, respectively, up 5% and down 4% compared to previous targets. Erste Group analysts hence stick to **Accumulate recommendations for both companies**.

- **Krka'**s top line tempo was subdued in 2009 and is seen to slow down to single-digit terms in 2010. Nonetheless, the company is poised to witness a stable business performance, with profitability parameters fueled by its strong innovation drive. While the share price recovery might still take some time, the currently depressed price levels remain very inviting. With a **revised target price of EUR 92.0 per share**, analysts confirm their **Buy recommendation**.

- While **Bioton**'s 2009 results are anticipated to stay deeply in red territory, the outlook for 2010 is not as gloomy, should the company's restructuring plans materialize. As before, Erste Group analysts opt to remain on the conservative side and stick to their **Hold recommendation**. Adjusting their model to incorporate the worse than expected 2009 interim results, delays in timing of the Bioton Wostok disposal and insulin market launch in China, as well as the newly introduced risk-related discount, the **new 12-month target price is PLN 0.21 per share (vs. the earlier PLN 0.26)**.

- Although Romanian pharmas' forex fortunes are set to be slightly more favorable this year, analysts expect their profitability margins to be squeezed by the worsening payment discipline and sales tax recently introduced in Romania. **The Antibiotice target price is revised to RON 0.624 per share and the Reduce recommendation on the stock is confirmed**. Although Erste Group analysts continue to view **Biofarm**'s position as slightly better, **their revised target price of RON 0.222 points to limited upside potential at the moment and they stick to Hold recommendation**.

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