Pharma distributors

# NEW PLAYERS AT BSE BIG PHARMA LEAGUE

## ROPHARMA, REMEDIA

**Sector Weighting**
**Neutral**
Preferred stock
**Remedia**
Least preferred stock
**Ropharma**

**Ropharma (RPH)**
**HOLD**

**TP RON 0.823**
**Upside 1.2%**

✓ Development strategy

**Remedia (RMAH)**
**HOLD**

**TP RON 0.230**
**Upside 4.3%**

✓ Growing company

- **Pharma distribution and retail sector** In contrast with producers/direct importers segment of the market which is dominated by few international players, distribution segment is more fragmented including over 200 companies, especially local players. Still, the features of a concentrate market became visible as top 20 distributors accounted for around 95% of the market, while top 10 players covered 84% (end June 2010 Cegedim data). The retail market includes approx. 6,000 pharmacies out of which approx. 1,400 are part of a chain and the rest are independent ones. Main players on both retail and wholesale market are usually part of the same group or controlled by the same majority shareholder. The prices for prescription drugs are regulated by the state and the margins for pharma distributors and retailers are capped by the Ministry of Health to 14% and 24% respectively, while the imported drugs prices are set in RON terms at a rate fixed also through a decision of the Ministry of Health.

- **Listed players** Pharmaceuticals distribution sector is represented at BSE by two issuers, namely Ropharma Brasov (RPH) and Remedia Deva (RMAH), both transferred from Rasdaq market in November 2010 and February 2009, respectively. Both companies are medium players on pharma distribution and retail segments operating a national spread network of several warehouses located in most important cities in Romania and a pharmacies chain covering usually four-five neighbour counties. Ropharma covers mainly the north, east and central part of Romania, while Remedia has a strong presence on the west and central regions. Additionally Ropharma is a niche player on production segment specialised on nutritive supplements based on lactoferrin. For the moment we prefer Remedia over Ropharma, as the price of the later increased significantly before the transfer to BSE tier 1 and currently the shares are traded at large premiums compared with sector average.

- **Alternative scenarios and risk to our scenario** Although we are positive regarding the long term perspective of the sector, on the short and medium term the industry has to face several challenges. In 2010 the main problem of the entire pharma market was the liquidity shortage because of delays in public payments for reimbursed drugs and drugs sold to hospitals. The payment period of 90 days to pharmacies and distributors was extended in July 2009 to 180 days and further to 210 days in April 2010. This forced market players to look for alternatives to finance their increased working capital needs which lead to higher financing costs and for the first time in 2010 two top ten pharma distributors, i.e. Montero and Relad filled for insolvency. However, although the liquidity problem remains, the exit of some players leaves room for the others to gain additional market share. Further risks arise from the price rigidity for prescription drugs which are capped by the Ministry of Health, amid a volatile FX environment, and from the limited expansion capacity for pharmacies chains because of deficit specialised personnel (pharmacists) and tight pharmacy authorisation rules.

| Key recommendations | Recommendation | Price | Target 12M | P/E '11e | EV/EBIT '11e | Div yld '11e | Comment |
|---|---|---|---|---|---|---|---|
| | | RON | RON | | | | |
| Ropharma | Hold | 0.813 | 0.823 | 21.7 | 17.2 | 0.0 | Development strategy |
| Remedia | Hold | 0.22 | 0.23 | 13.7 | 9.3 | 1.1 | Growing company |

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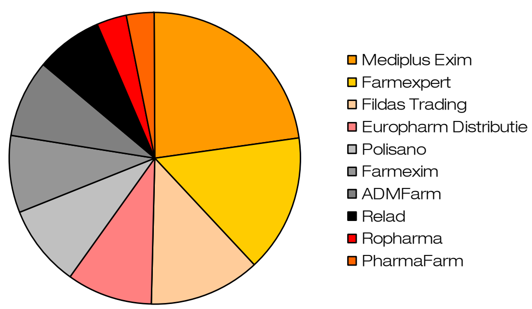
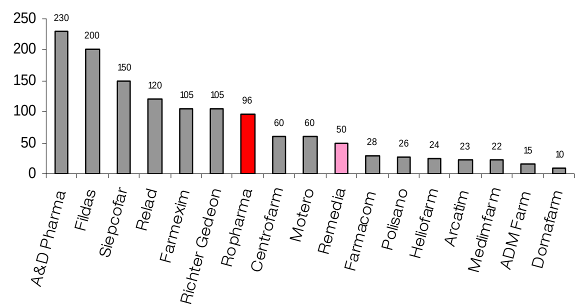
**Market share Top 10 Distributors H1'10**




Source: Cegedim

**Retail market (as number of pharmacies – end June 2010)**




Source: Cegedim

## Pharma distribution and retail market

Currently Romanian pharma distribution market is quite fragmented with around 200 competitors but exhibits the features of a concentrated market as top ten players accounted for 84.3% market share at end June 2010 (Ropharma Prospectus citing Cegedim report). All main players are local companies, the top being dominated by Mediplus, the distribution division of A&D Pharma with 19.3% market share, followed by Farmexpert with 12.8% and Fildas Trading with 10.4% (end June 2010 Cegedim data). Most of top ten players have a national wide presence with warehouses located in the most important Romanian cities. Pharma distributors' activity is highly regulated: the companies acting as distributors are authorized by the National Drug Agency and they can only distribute drugs having a market authorization from the same institution. Moreover, the wholesale margin for prescription drugs are capped to currently a maximum of 14% through the regulations issued by the Ministry of Health. Additionally pharma distributors can sell OTC drugs and related products such as medical accessories, cosmetics and hygiene products.

The retail market is the most fragmented segment of pharma market with approx. 6,500 units out of which around 21% are part of a pharmacies chain and the rest are independent ones. Market leader is A&D Pharma with Sensiblu chain of 230 units, followed by Fildas with Catena chain of 200 units and Siepcofar with Donna chain of 150 units (end June 2010 data, Ropharma prospectus). The pharmacies are authorised by the Ministry of Health and have to comply with a set of tight regulations regarding the location (one pharmacy to 3,000 inhabitants in Bucharest, 3,500 inhabitants in the counties seats and 4,000 inhabitants In other cities), the minimum necessary area (50 sqm) the specialised personnel etc. Also, the prices for prescription drugs which are established by the Ministry of Health as well a maximum retail gross margin which is capped to 24%.

The sector is confronting with the acute problem of liquidities shortage because of overdue debts of the state to drugs suppliers, which is spread over the whole chain from retail to production. First affected are the independent pharmacies which have limited access to financial sources. Confronted with bankruptcy threat, they are usually bought by a retail chain especially as the organic growth is limited by the deficit of specialised personnel and the legal restrictions regarding pharmacies location. However, the liquidities shortage became so generalized as in 2010 two of top ten distributors namely Relad and Montero filled for insolvency. The financing problem is rolled on to the producers which practically are sustaining the whole industry. This is the highest short term risk threatening the pharma industry which must be mitigated in order to unlock the long term growth potential of the sector.

Pharma distributor

# ROPHARMA

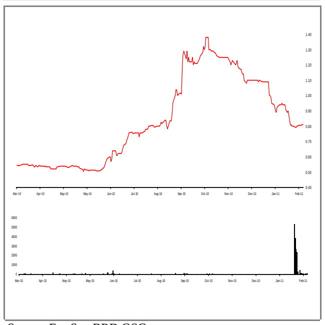
**Hold** (12m)

| Price03/03/11 | Target Price |
|---|---|
| RON 0.813 | RON 0.823 |

**Sector**
Weighting
**Neutral**
Preferred stock
**Remedia**
Least preferred stock
**Ropharma**

**Type of investment**
Development strategy ✓

**1 year price and volume**



Source: FactSet, BRD GSG

**Risk**

| | |
|---|---|
| Stock vs sector | Underwieght |
| Sector vs market | Neutral |

**Ropharma on www.ropharma.ro**

- **Investment case** We initiate our coverage on Ropharma with a Hold recommendation suggested by our 12M target price of RON 0.823 which translates in a modest 1.2% upside to current price. Following the merger operated in January 2009 with other three pharmaceutical companies, Ropharma became a medium size player on distribution and retail segments and a niche player on production segment of Romanian pharmaceutical market. In November 2010, company's shares were transferred to the first tier of BSE. The company is controlled by the businessman Mr. Mihai Miron through several investments vehicles. On the medium run we see as key drivers the production growth potential which will lead to improved operational margin and distribution and retail chain expansion through organic growth and acquisitions. On the long run Romanian pharmaceutical market is expected to cover the current gap compared to EU average in terms of drugs expenditure per capita (currently EUR 125 compared to EU average of EUR 330) and healthcare expenditure as percentage of GDP (currently 4.6% compared to EU average of 8.8%), which will determine solid market growth potential.

- **Catalysts for the share price** The price increased significantly during September – November 2010 before the transfer to BSE tier 1, and then corrected sharply at mid February 2011 when the owner sold some 5.2% stake. Preliminary 2010 results were in line with the budget and our expectations and didn't have much influence on the price. However, selling pressures could be offset by the company announced shares buy back programme of about 3.95% stake started as of end October 2010 for a period of 18 months.

- **12M target price and methodology** Our target price was determined based on a two stages DCF method with an explicit period of five years (2011-2015) and a second mature growth period. FCFF from the explicit period were discounted using a variable WACC between 13.4% in 2011 and 12.4% in 2015. For the second stage of mature growth period we assumed a WACC of 11.9% and a long term growth rate of 2.5%.

- **Alternative scenarios and risk to our scenario** We consider our valuation results might be affected by several macroeconomic, sector and issuer specific risks. Most important are sector risks: industry liquidity problem, deficit of specialised personnel (pharmacists), regulatory risks related to prices regime, reimbursed drugs conditions, authorisation of distribution and retail units, hospitals reorganisation. Also, an unfavourable macroeconomic environment with prolonged recession implying low private consumption, high FX volatility and high risk aversion from foreign investors could affect Ropharma performance.

- **Next events** Annual General Shareholders Meeting on 28 April 2011.

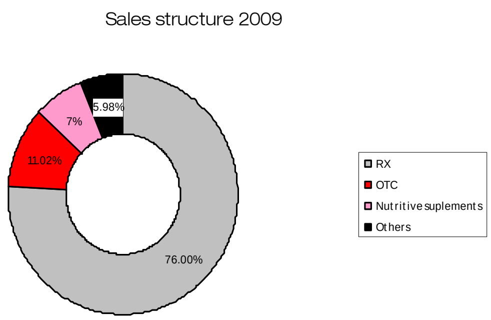
| Share data | | | |
|---|---|---|---|
| **RIC RPHR.BX , Bloom RPH RO** | | | |
| 52 weeks range | | | 0.48 – 1.38 |
| Mk. Cap. (RONm) | | | 236.6 |
| Free float (%) | | | 24.4 |
| **Performance (%)** | **1m** | **3m** | **12m** |
| Ordinary shares | -14.4 | -33.4 | 49.6 |
| BET | 3.1 | 13.4 | 7.0 |

| Financial data (RON) | 2009 | 2010p | 2011e | 2012e |
|---|---|---|---|---|
| Operating revenues (m) | 289.2 | 354.1 | 389.8 | 424.7 |
| Net profit (m) | 4.2 | 10.8 | 10.9 | 15.0 |
| CFO | -0.149 | -0.013 | 0.053 | 0.034 |
| EPS | 0.033 | 0.037 | 0.037 | 0.052 |
| BVPS | 0.384 | 0.281 | 0.318 | 0.370 |
| Gross Dividend | 0 | 0 | 0 | 0 |
| Payout (%) | 0 | 0 | 0 | 0 |
| Net debt/equity (%) | 21.8 | 20.6 | 7.8 | 2.0 |

| Ratios | 2009 | 2010p | 2011e | 2012e |
|---|---|---|---|---|
| P/E (x) | 10.7 | 21.9 | 21.7 | 15.8 |
| P/CFO (x) | nm | nm | 15.5 | 24.2 |
| P/Sales (x) | 0.2 | 0.7 | 0.6 | 0.6 |
| P/B (x) | 0.9 | 2.9 | 2.6 | 2.2 |
| EV/EBITDA (x) | 4.7 | 14.1 | 12.2 | 10.3 |
| EV/EBIT (x) | 7.8 | 19.5 | 17.2 | 12.8 |
| Dividend yield (%) | 0 | 0 | 0 | 0 |
| ROIC/WACC (x) | na | na | 1.1 | 1.3 |

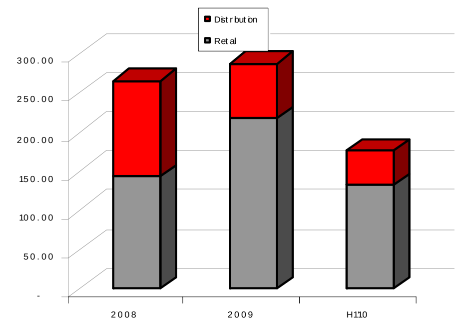
# Company anatomy – business overview

## Sales structure 2009



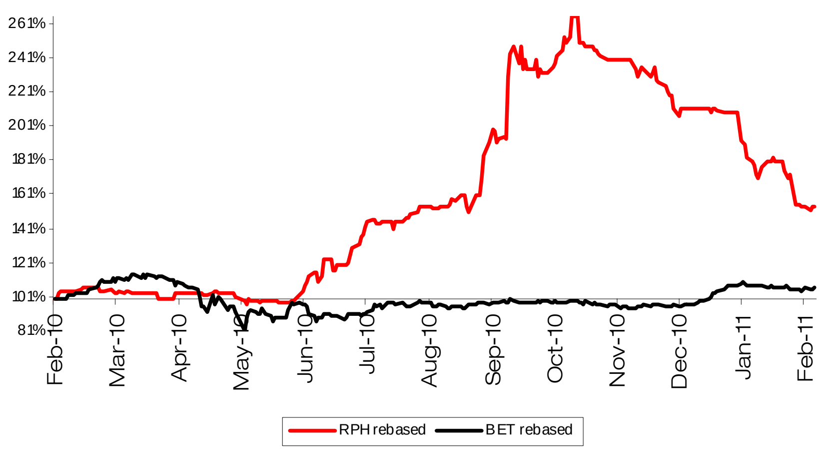

Source: Ropharma

## Sales breakdown retail/distribution 2008 – H1'10 (RON m)




Source: Ropharma

## RPH vs. BET share price performance




Source: Reuters, BRD GSG

# Investment summary

## Main arguments for our recommendation

### BRD GSG view

Our **Hold recommendation** is based on the results of our employed valuation methods both DCF valuation and peers comparison. To those quantitative items we add the short term risks faced by the whole sector related to the liquidities problem which recently forced the exit from the market of two top ten distributors. Moreover, during September 2010 – November 2010 the price increased significantly as a consequence of the expected transfer to BSE tier 1 and was partially corrected in February 2011 when the company's owner sold 5.2% shares increasing the free float to 24.4%. Still, we think selling pressure will be mitigated by the company's share buy back programme started in October 2010 and targeting the acquisition of 3.95% stake for the employees' stock option plan during a period of maximum 18 months, for a price between RON 0.1 and RON 3. As of 25 February 2011 Ropharma reported the acquisition of shares representing 3% of the planned figure.

Ropharma is a medium size player on the distribution (wholesale) and retail pharmaceutical market and a small niche player on the drugs production segment controlled by the business man Mr. Mihai Miron through several investments vehicles. In 2009, after the merger with other three retail and distribution pharmaceutical companies, Ropharma business tilted to retail activity (approx. 80% of 2010 turnover compared to 53.5% in 2008). The company owns five warehouses which cover approx 75% of Romanian territory, having a market share on distribution segment of 2.85% (end June 2010, Cegedim data) and a retail chain of 96 pharmacies representing 1.5% of total number of retail units in Romania and having 3.75% market share according to company's estimation. Also, Rohparma, operates through its subsidiary Aesculap Prod SRL, a small production unit specialised in nutritive supplements based on lactoferrin, a protein of immune body system purified from milk. Aesculap is the sole manufacturer of lactoferrin based products, but has little awareness among consumers.

On medium run, we identified as key drivers the growth of production segment and expansion of own products portfolio which will improve operational margins (management forecast production to reach EUR 10m by 2014 compared to EUR 1m in 2010) and expansion of distribution and retail chain through organic growth or acquisitions (management plans to open 6 to 10 pharmacies annually In the next two-three years).

On the long run, the company should benefit of the convergence process between Romanian pharmaceutical market and EU average in terms of healthcare expenditure per capita, drugs expenditure per capita and increase of preventive drugs consumption, including OTC and nutritive supplements. Currently, Romanian market hovers around half of EU average both in terms of drugs sales per capita (EUR 125 vs. EU average EUR 330) and health expenditure as percentage of GDP (4.6% vs. EU average of 8.8%).

### Summary valuation

We valued Ropharma using a two stages DCF model. Our model derived a fair price of RON 0.719, leading to a 12M target price of RON 0.823. We explicitly forecast FCFF for the period 2011-2015 based on company's guidance, market and macroeconomic trends and in house forecasts. FCFF were discounted to a variable WACC for 2011-2015 period, ranging between 13.4% and 12.4% in order to reflect Romanian particular macro environment. For the terminal period we used a WACC of 11.9% and a long term growth rate of 2.5%, taking into account the large gap between Romanian pharmaceutical market and European average under the conditions of convergence process. Alternatively, we conducted a relative valuation using a peers group from Europe. At current price (RON 0.813 as of March 03, 2011) Ropharma looks expensive relative to its peers in terms of all analysed multiples: P/E (+94.1% in 2010 and +76.5% in 2011), EV/EBITDA (+70.2% in 2011 and 69.6% in 2012), EV/EBIT (82.9% in 2010 and 66.3% in 2011).

# Other investments considerations

## Alternative scenarios and risks

Going top down we identified the following risks which could affect our valuation results:

Macroeconomic risks:

- Slowly economic recovery implying deteriorated consumer purchasing power and consequently lower out of pocket drugs consumption;
- higher FX volatility with negative influence on acquisition costs for imported drugs;
- increase of investors risk aversion to Romanian assets driven by poor of macroeconomic fundamentals;

Sector risks:

- regulatory risk is significant as pharma market is highly regulated (including changes to prices regime, conditions for authorisation of pharmacies and pharma distributors, changes related to the reimbursed drugs programme, changes regarding public healthcare system – e.g. hospitals reorganisation);
- limited growing potential of the retail chain because of specialised personnel deficit (pharmacists);
- liquidities shortage which is spread to the whole industry because of overdue public debts to drugs producers and healthcare services providers;
- limited gross margin as prices for prescription drugs are capped by the Ministry of Health which also establish maximum margins for pharma distributors and retailers;

Issuer specific risks:

- own products brand (lactofferin based products) has little awareness among consumers;
- partial exposure of the retail chain to regions with low income per capita;
- limited minority shareholders power as the company is practically controlled by a sole individual which his also heading the executive management.

# Company overview

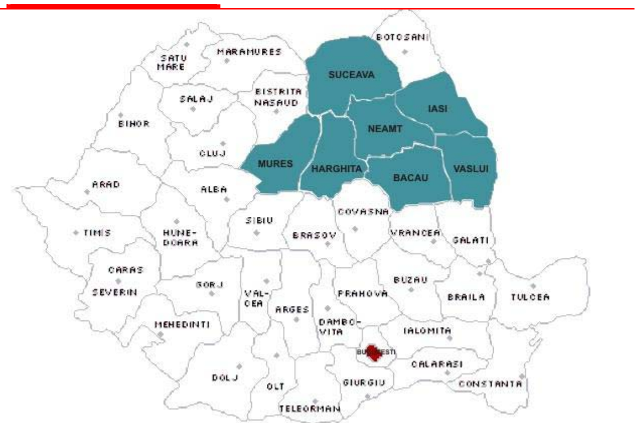
The company was set up back in 1991 as Iassyfarm SA, a state owned distribution and retail pharmaceutical company, covering the north-eastern part of Romania. In 1995, 30% of the shares were distributed to individual investors through mass privatisation programme, and further on 1998 the state sold its stake to ADD Pharmaceuticals LTD a Cyprus based company owned by Romanian businessman, Mr. Mihai Miron. In 2007 company's headquarter is relocated from Iasi to Brasov and the name is changed into Ropharma. In January 2009 Ropharma merged with other three pharmaceutical companies controlled by Mr. Mihai Miron: Farmaceutica Aesculap SA Tg Mures, owner of Aesculap Prod SRL with production activities, Medica SA Bacau and Global Pharmaceuticals Brasov. Currently, Ropharma is controlled by Mr. Mihai Miron (which is also General Manager and Chairman of the Board) through three companies: ADD Pharmaceuticals LTD, Rimia Investments Limited (both based in Cyprus) and Arrow Pharmaceuticals INC St Petersburg based in USA, cumulating 75.3% stake.

Ropharma is a medium size player on the Romanian pharma distribution and retail market, and a small niche player on the production segment through its subsidiary Aesculap Prod. After the merger operated in January 2009 the retail activity became the core of Ropharma business (approx 80% of 2010 turnover compared to 53.5% in 2008). The company operates 96 pharmacies located in the northern east of Romania in seven neighbour counties, i.e. Iasi, Vaslui, Suceava, Bacau, Neamt, Mures, Harghita. The distribution activity is organized through five branches i.e. Bucharest, Iasi, Bacau, Targu-Mures and Cluj-Napoca, covering approx. 75% of Romania's territory, mainly northern, central and eastern regions. Ropharma sales the whole range of pharmaceutical products: patented Rx drugs, generic Rx drugs, OTC drugs, nutritive supplements and other products (baby products, antiseptic products, medical accessories, cosmetics and hygiene products). Ropharma collaborates with the majority of local producers and drugs importers and offers over 12,500 products (3,000 prescription drugs, 700 OTC drugs, 1,800 nutritive supplements, 3,100 dermatologic cosmetics, 1,600 medical accessories, 2,300 other products).

**Ropharma distribution area**


Source: Ropharma

**Ropharma retail area**




Source: Ropharma

Following the merger with Farmaceutica Aesculap, Ropharma owns indirectly Aesculap Prod SRL a small production unit manufacturing a series of nutritive supplements based on plants and lactoferrin, a protein of body's immune system which can be separated from milk. Currently the products rage is rather limited to three categories: lactoferrin based products – nutritive supplements based on the milk extracted protein lactoferrin, vitamins and minerals and antacids, accounting only for 1.2% of 2010 Ropharma sales.

### BSE trading

Ropharma shares were transferred to the first tier of Bucharest Stock Exchange starting with 24 November 2010 under the ticker RPH, while previously the shares were traded on the Rasdaq market third tier under the ticker IAFR (since 1997). According to Mr. Miron, representative of the controlling stake and general manager, the reasoning behind the transfer to the "big league" of BSE is the company's intention of financing its development plans through capital market means. In September 2010 the general shareholders meeting approved a share capital increase from RON 12.65m to RON 29.1m through incorporation of retained earnings and distribution of bonus shares (1.3 new shares for every share owned).

## Key drivers

### Market positioning

Ropharma acts on all three segments of Romanian pharmaceutical market: production, wholesale (distribution) and retail. Traditionally its main activity was distribution of pharmaceutical products, but following the merger with Farmaceutica Aesculap SA Tg Mures, Medica SA Bacau and Global Pharmaceuticals Brasov in January 2009, the core business became the retail activity with aprox 80% of 2010 sales and 75.4% of 2009 sales. Also, the company entered indirectly on the production segment through Aescupal Pord SRL a subsidiary of Farmaceutica Aesculap SA Tg Mures, manufacturing nutritive supplements based on plants and lactoferrin.

On the production segment Ropahrma is a small niche player specialised mainly in nutritive supplements based on lactoferrin, a protein of immune body system purified from milk and other vitamins and minerals products. The best known brand is Activit including the products based on lactoferrin. Still, the products have little awareness among consumers, while the segment of nutritive supplements and vitamins is a very competitive one.

On the distribution segment Ropharma is a medium size player with a 2.85% market share at end June 2010 according to a company release citing Cegedim data. Ropharma has five warehouses located mainly in the northern, central and eastern part of Romania, deserving over 1,200 pharmacies.

After the merger from 2009 with Farmaceutica Aesculap SA Tg Mures, Medica SA Bacau and Global Pharmaceuticals Brasov, Ropharma became also a top ten player on the retail market (considering the number of pharmacies) with 96 units located in the northern and eastern part of Romania. Ropharma ranks seventh place regards the operated units.

### Strategic plans

For the next two years the management plans to impose a new Ropharma image to pharmaceutical market under the corporate identity producer – importer – distributor – pharmacies chain, by applying different development strategies to all segments.

Although the production segment is rather small for the moment representing only 1.2% of 2010 sales, the management plans to develop production activity by investing in new equipment for the plant – in order to be able to produce other pharmaceutical forms (tripled stratified tablets and powders), by enlarging the product portfolio (in 2010 eight new products were launched) and by promoting the main company's brand Activit. The management forecast for production segment growth are quite ambitious from EUR 1m in 2010 to EUR 3m in 2011 and then EUR 10m in 2014.

In the distribution segment the management sees opportunities to gain additional market share following the exit of some players through promoting Ropharma brands to large pharmacies chains, medical professionals and patients. Still, the company didn't mention, if it plans to open new warehouses in order to gain wider national exposure.

On the retail segment the management plans to further develop the pharmacies' chain by 6 to 10 new units per year both through organic growth and acquisitions. The main marketing strategies for 2011-2012 include the strengthening of Ropharma pharmacy image, patient loyalty campaigns, presentations for physicians, promoting of Ropharma own brands.

# Financials overview

Because of the merger operated in January 2009, a comparison of absolute historical financial figures or annual growth is not meaningful. However, we can observe top line advance in 2010 (preliminary data) by 22% yoy to RON 352.13m, following the market trend, while net profit climbed to RON 10.8m, more than double compared to the same period previous year.

Starting with 2009 Ropharma sales structure changed in the favor of retail sales (approx. 80% of 2010 sales and 75.4% of 2009 sales compared to 53.5% in 2008) due to the expansion of the retail chain following the merger with the other three companies, but also to a management active strategy of mitigating default risk of its client pharmacies. Thus, the company applied a more restricted clients' policy selection and inclusive ended contracts with clients having payment difficulties. The growth of retail stake improved the gross margin from 8.2% in 2008 to 20% in 2009 and then 21.1% in 2010 (preliminary data), as maximum retail margin for drugs sales is capped at 24%, while maximum whole sale margin is capped at 14% by the Ministry of Health. The other operating expenses categories posted quite constant margins following the merger as the three companies are acting in the same sector and have a similar expenses structure. Still, we noted personnel expenses margin advance from 7.6% in 2008 to 8.8% in 2009 and 8.2% in 2010, probably due to a higher budget allocated to marketing/sales sector.

The merger synergies became more visible in 2010 as operating margin reached 3.7% vs. 2.4% in 2009 and net margin increased to 3.1% vs. 1.4% in 2009.

As we mentioned before, a comparison of historical data before 2009 is meaningless, but on the balance sheet side we noted a few significant changes during 2009-2010 period. First, as of end 2010 Ropharma operated a revaluation of its buildings and land plots which added approx RON 23.8m to the net value of company's tangibles. Then in September 2010, EGSM approved a share capital increase from RON 12.65m to RON 29.1m through incorporation of retained earnings and distribution of bonus shares (1.3 new shares for every share owned). The capital increase was operated in December 2010.

The general liquidity problem of the industry is also visible if we look at working capital movements as trade receivables days significantly increased from 137 in 2009 to 192 in 2010, while trade payables days advanced from 142 to 176 over the same period. However, the company managed to have a better inventory control as inventories turnover declined from 43 days in 2009 to 30 days in 2010. Additionally short term loans increased by 40.6% yoy reaching to RON 26.8m at end 2010, but indebtedness ratios improved as a consequence of the share capital increase operation and increased profitability margins (debt/equity declined to 39% in 2010 from 48% in 2009, interest coverage ratio advanced to 11.5 in 2010 from 6 in 2009).

# Valuation

## Target price calculation and fundamental valuation

We used a fundamental valuation approach by constructing a two stages DCF model, with a first explicit period of five years (2011-2015) and a mature growth period. Our estimates for the explicit period are based on company's guidance, market and macroeconomic trends and in house forecasts. In constructing sales estimates we conservatively considered Ropharma will grow in line with the market. We expect the gross margin to maintain a fairly linear pattern around 20% during 2011-2013 period and to improve to 22% after 2013 based on the increase of own drugs sales which have a higher margin. We also expect receivables turnover to decrease to 145 days by 2015 and accounts payable days to reach 125, while inventory days will rather remain around the current values. As regarding capital expenditure we incorporated annual investments in equipments (production equipments, cars fleet and pharmacies furniture) of RON 3m in average during 2011-2015 period.

Our FCFFs of the explicit period were discounted using a variable WACC between 13.4% and 12.4% implying a risk free rate of 7% during 2011-2012 period and 6.5% during 2013-2015, a market risk premium of 7.5% for 2011-2012 and 7% for 2013-2015 and a beta of 1 determined as average beta for the peers group used in relative valuation approach. For the terminal period we used a WACC of 11.9% and a long term growth rate of 2.5%.

**Table 1**

FCFF assumptions & results

| Indicator (RONm) | 2011e | 2012e | 2013e | 2014e | 2015e |
|---|---|---|---|---|---|
| **EBIT** | **14.13** | **18.62** | **22.96** | **33.54** | **37.01** |
| EBIT*(1-t) | 11.87 | 15.64 | 19.28 | 28.17 | 31.09 |
| +D&A expenses | 5.84 | 4.54 | 3.41 | 3.65 | 3.88 |
| - CAPEX | -3.50 | -3.30 | -2.80 | -2.80 | -2.75 |
| - change in Working Capital | -2.93 | -10.23 | -7.07 | -2.29 | -4.58 |
| FCFF | 11.28 | 6.65 | 12.82 | 26.74 | 27.63 |
| **WACC** | **13.4%** | **13.4%** | **12.4%** | **12.4%** | **12.4%** |
| Discounted FCFF | 10.17 | 5.29 | 9.07 | 16.82 | 15.47 |
| Present value of FCFFs | 56.82 | | | | |
| Terminal value | 301.15 | | | | |
| Firm fair value | 226.16 | | | | |
| (-) net debt (Dec'09) | 16.85 | | | | |
| Equity value | 209.31 | | | | |
| Fair value per share | 0.719 | | | | |
| **Target price 12M** | **0.823** | | | | |
| Closing Price as of | 0.813 | | | | |
| **Upside/downside potential** | **1.21%** | | | | |

Source: BRD GSG estimations

At the current market price of RON 0.813 our target price translates into a modest potential upside of 1.2% leading to a Hold recommendation.

## Sensitivity

We conducted a sensitivity analysis on WACC and g which lead to the conclusion that our fair price is influenced by both of them: a variation of one percentage point in WACC determined a variation of 4.1-4.3% of our fair value, while a change of 50 bps in g lead to a volatility of 4.5-5% in fair value.

**Table 2**

Fair value per share sensitivity to WACC and g

| g/WACC | WACC-2% | WACC-1% | WACC | WACC+1% | WACC+2% |
|---|---|---|---|---|---|
| **1.5%** | 0.7169 | 0.6868 | 0.6582 | 0.6310 | 0.6051 |
| **2%** | 0.7485 | **0.7171** | **0.6872** | **0.6588** | 0.6317 |
| **2.5%** | 0.7834 | **0.7505** | **0.7193** | **0.6895** | 0.6612 |
| **3%** | 0.8223 | **0.7878** | **0.7549** | **0.7237** | 0.6940 |
| **3.5%** | 0.8659 | 0.8295 | 0.7949 | 0.7619 | 0.7306 |

Source: BRD GSG estimations

## Other valuation methodologies

We conducted a relative valuation by comparing Ropharma price multiples with the means of a selected peers group of companies acting in pharmaceutical sector from Europe, mainly Poland. Farmacol SA, Polska Grupa Farmaceutyczna SA and Neuca SA are three Poland based companies running activities such as distribution and retail of pharmaceuticals, medical and rehabilitation equipment, herbal preparations and cosmetics. Oriola-KD Oyj is a Finnish company active in pharmaceuticals wholesale and healthcare segments with operations in Finland, Sweden, Russia and the Baltic countries. Ropharma looks expensive compared to its peers as it trades at large premiums as regards all multiples.

**Table 3**

Peers valuation

| Company | Ticker | Mk cap EUR m | P/E | | EV/EBITDA | | EV/EBIT | | P/SALES | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | **2011** | **2012** | **2011** | **2012** | **2011** | **2012** | **2011** | **2012** |
| Farmacol SA | FCOL.WA | 208.58 | 8.3 | 7.9 | 6.2 | 5.9 | 6.9 | 6.5 | 0.1 | 0.1 |
| POLSKA GRUPA FARMACEUTYCZNA SA | MDIC.WA | 164.41 | 10.4 | 9.5 | 8.0 | 7.1 | 10.1 | 9.0 | 0.1 | 0.1 |
| Neuca SA | TORF.WA | 91.77 | 8.6 | 7.7 | 7.7 | 6.9 | 10.0 | 8.8 | 0.1 | 0.1 |
| Oriola KD Oyj | OKDBV.HE | 535.63 | 14.9 | 10.8 | 8.6 | 6.3 | 10.8 | 7.7 | 0.3 | 0.2 |
| Remedia | RMAH.BX | 5.55 | 13.7 | 8.8 | 5.3 | 4.2 | 9.3 | 6.6 | 0.1 | 0.1 |
| **Average** | | **201.19** | **11.20** | **8.95** | **7.17** | **6.08** | **9.43** | **7.71** | **0.14** | **0.13** |
| **Median** | | **186.49** | **9.51** | **8.70** | **7.85** | **6.60** | **10.08** | **8.23** | **0.13** | **0.12** |
| **Ropharma** | **RPHR.BX** | **56.31** | **21.7** | **15.8** | **12.2** | **10.3** | **17.2** | **12.8** | **0.6** | **0.5** |
| **Premium/Discount** | | | **94.1%** | **76.5%** | **70.2%** | **69.6%** | **82.9%** | **66.3%** | **320.5%** | **307.9%** |

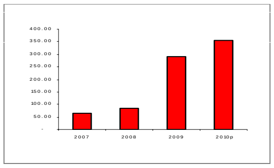
Source : Reuters, BRD GSG estimations

Pharma(Romania)

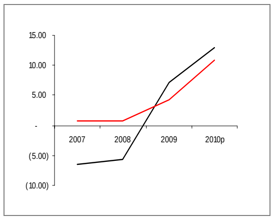
# ROPHARMA

| | HOLD | Price (03/03/2011) | 12m target |
|---|---|---|---|
| | | RON 0.813 | RON 0.823 |

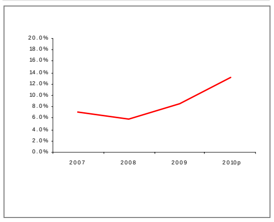
**Operating revenues (RONm)**




**EBIT and net profit (RONm)**




**ROE evolution (%)**




**Major shareholders (%)**

| | |
|---|---|
| Arrow Pharmaceuticals INC. St Petersburg USA | 31.3 |
| Rimia Investments Limited Limassol CYP | 21.4 |
| ADD Pharmaceuticals LTD Limassol CYP | 22.6 |
| AVAS | 0.3 |
| Others | 24.4 |

| Valuation* (RON m) | 2008 | 2009 | 2010p | 2011e | 2012e | 2013e | 2014e |
|---|---|---|---|---|---|---|---|
| Average nb of shares (diluted) | 39.4 | 126.5 | 291.0 | 291.0 | 291.0 | 291.0 | 291.0 |
| Share price | 0.110 | 0.353 | 0.813 | 0.813 | 0.813 | 0.813 | 0.813 |
| EV | 3.5 | 55.3 | 253.4 | 243.8 | 238.8 | 233.0 | 214.4 |
| P/E (x) | 6.0 | 10.7 | 21.9 | 21.7 | 15.8 | 12.5 | 8.5 |
| P/CFO (x) | -4.9 | -2.4 | -63.1 | 15.5 | 24.2 | 15.0 | 8.0 |
| EV/EBITDA (x) | -0.8 | 4.7 | 14.1 | 12.2 | 10.3 | 8.8 | 5.8 |
| EV/EBIT (x) | -0.6 | 7.8 | 19.5 | 17.2 | 12.8 | 10.1 | 6.4 |
| P/B(x) | 0.3 | 0.9 | 2.9 | 2.6 | 2.2 | 2.0 | 1.7 |
| P/Sales (x) | 0.1 | 0.2 | 0.7 | 0.6 | 0.6 | 0.5 | 0.5 |
| Dividend yield | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 2.4% | 3.5% |
| **Per share data (RON)** | | | | | | | |
| EPS | 0.018 | 0.033 | 0.037 | 0.037 | 0.052 | 0.065 | 0.096 |
| CFO | -0.022 | -0.149 | -0.013 | 0.053 | 0.034 | 0.054 | 0.102 |
| Book value | 0.317 | 0.384 | 0.281 | 0.318 | 0.370 | 0.415 | 0.482 |
| Dividend | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.020 | 0.029 |
| **Income statement (RON m)** | | | | | | | |
| Total Operating revenues | 84.2 | 289.2 | 354.1 | 389.8 | 424.7 | 457.5 | 492.4 |
| EBITDA | -4.4 | 11.8 | 17.9 | 20.0 | 23.2 | 26.4 | 37.2 |
| Depreciation, depletion and amort. | -1.3 | -4.7 | -4.9 | -5.8 | -4.5 | -3.4 | -3.7 |
| EBIT | -5.7 | 7.1 | 13.0 | 14.1 | 18.6 | 23.0 | 33.5 |
| Net interest income | -0.1 | -1.0 | -1.0 | -1.2 | -0.8 | -0.4 | -0.4 |
| EBT | 0.9 | 5.3 | 13.4 | 13.0 | 17.8 | 22.6 | 33.2 |
| Corporate tax | -0.2 | -1.1 | -2.6 | -2.1 | -2.9 | -3.6 | -5.3 |
| Net profit | 0.7 | 4.2 | 10.8 | 10.9 | 15.0 | 19.0 | 27.9 |
| **Cash flow statement (RON m)** | | | | | | | |
| Net profit | 0.7 | 4.2 | 10.8 | 10.9 | 15.0 | 19.0 | 27.9 |
| Depreciation, depletion and amort. | 1.3 | 4.7 | 4.9 | 5.8 | 4.5 | 3.4 | 3.7 |
| Change in working capital | -4.2 | -25.0 | -15.3 | -2.9 | -10.2 | -7.1 | -2.3 |
| Cash flow from operating activities | -0.9 | -18.8 | -3.8 | 15.3 | 9.8 | 15.8 | 29.7 |
| Net capital expenditure | -2.0 | -29.5 | -3.5 | -3.5 | -3.3 | -2.8 | -2.8 |
| Cash flow from investing activities | -1.7 | -28.1 | -3.5 | -3.5 | -3.3 | -2.8 | -2.8 |
| Cash flow from financing activities | 0.4 | 52.5 | 8.7 | -11.4 | -7.5 | -13.7 | -8.4 |
| Net change in cash resulting from CF | -2.2 | 5.6 | 1.5 | 0.4 | -1.0 | -0.7 | 18.6 |
| **Balance sheet (RON m)** | | | | | | | |
| Total long-term assets | 9.4 | 37.5 | 61.7 | 59.4 | 58.1 | 57.5 | 56.7 |
| of which tangible | 9.4 | 31.4 | 54.2 | 51.5 | 50.0 | 49.3 | 48.5 |
| Working capital | 5.2 | 30.2 | 45.5 | 48.4 | 58.6 | 65.7 | 68.0 |
| Long term liabilities | 0.6 | 4.2 | 5.1 | 5.5 | 3.0 | 0.0 | 0.0 |
| of which long term debt | 0.0 | 0.0 | 0.0 | 2.5 | 1.5 | 0.0 | 0.0 |
| Shareholders' equity | 12.5 | 48.6 | 81.7 | 92.5 | 107.5 | 120.8 | 140.3 |
| Net debt (+)/cash (-) | -0.8 | 10.6 | 16.8 | 7.2 | 2.2 | -3.6 | -22.2 |
| **Accounting ratios** | | | | | | | |
| ROIC | -43.9% | 13.4% | 15.0% | 14.4% | 16.8% | 19.0% | 23.9% |
| ROE | 5.8% | 8.6% | 13.2% | 11.8% | 13.9% | 15.7% | 19.9% |
| Sales growth (%) | 34.5% | 250.3% | 22.1% | 10.4% | 9.0% | 7.7% | 7.6% |
| EBITDA margin | -5.3% | 4.1% | 5.1% | 5.1% | 5.5% | 5.8% | 5.8% |
| EBIT margin | -7.0% | 2.4% | 3.7% | 3.6% | 4.4% | 5.0% | 6.8% |
| Net income margin | 0.9% | 1.4% | 3.1% | 2.8% | 3.5% | 4.2% | 5.7% |
| Current ratio | 1.1 | 1.1 | 1.1 | 1.2 | 1.3 | 1.3 | 1.4 |
| Net debt/equity | -0.1 | 0.2 | 0.2 | 0.1 | 0.0 | 0.0 | -0.2 |
| Interest cover (x) | na | 6.0 | 11.5 | 12.0 | 24.0 | 65.6 | 95.8 |
| Payout ratio (%) | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 30.0% | 30.0% |
| ROIC/WACC(x) | na | na | na | 1.1 | 1.3 | 1.5 | 1.9 |

* Valuation rati os for past years are based on current price

Romania

Initiation of coverage

March 2011

Pharma distributor

# REMEDIA

**Hold** (12m)

| Price 03/03/11 | Target Price |
|---|---|
| RON 0.220 | RON 0.230 |

**Sector**

Weighting
**Neutral**

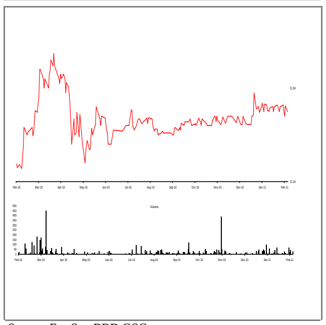
Preferred stock
**Remedia**

Least preferred stock
**Ropharma**

**Type of investment**

Growing company ✓

**1 year price and volume**



Source: FactSet, BRD GSG

**Risk**

| | |
|---|---|
| Stock vs sector | Neutral |
| Sector vs market | Neutral |

**Remedia on www.remedia.ro**

- **Investment case** We initiate our coverage on Remedia stock with a Hold recommendation as our target price of RON 0.23 offers a modest upside of 4.3% compared to current market price of RON 0.22 as of 3 March 2011). Remedia is a medium size player on pharma distribution and retail market owning eight warehouses located in the central and west part of the country and 50 pharmacies located mainly in the west part of Romania. The company is controlled by Mr. Tarus Valentin Norbert which owns 66% of the shares and is also president of the Board of Directors. As main drivers on the medium run we see the business expansion especially on the retail segment which could bring scale economies and improved profit margins. On the long run, Romanian pharmaceutical market is expected to cover the current gap compared to EU average in terms of drugs expenditure per capita (currently EUR 125 compared to EU average of EUR 330) and healthcare expenditure as percentage of GDP(currently 4.6% compared to EU average of 8.8%) , which will determine solid market growth potential.

- **Catalysts for the share price** In the last 7 months the price appreciated by 7.5% being sustained by Remedia's shares buy back programme started in August 2010 for a 12 months period. As of 25 February 2011 the company acquired 0.55m shares i.e. 31% of the planned amount at an average price of RON 0.2. For the next period we expect the price to follow the same slow ascending pattern.

- **12M target price and methodology** Our 12M target price was derived from a two stages DCF model with a 5 years explicit period (2011-2015) and a second mature growth period. FCFF from explicit period were discounted at a WACC between 13.7% and 12.5%, while for the terminal period we used a WACC of 12.1% and a long term growth rate of 2.5%.

- **Alternative scenarios and risk to our scenario** There are several risks related to out main scenario, mainly industry specific, but also macroeconomic and issuer's risks. Going top down we can mention poor consumer purchasing power and consequently lower out of pocket drugs consumption, regulatory risk including changes to prices regime, conditions for authorisation of pharmacies and pharma distributors, changes related to the reimbursed drugs programme, changes regarding public healthcare system – e.g. hospitals reorganisation, liquidities shortage which is spread over the whole industry, limited growing potential of the retail chain, because of specialised personnel deficit (pharmacists).

- **Next events** Annual General Shareholders Meeting on 21 April 2011.

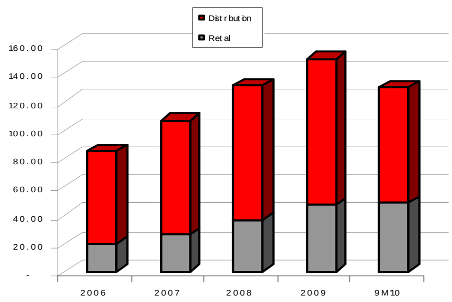
| Share data | | | |
|---|---|---|---|
| **RIC RMAH.BX , Bloom** | **RMAH RO** | | |
| 52 weeks range | | | 0.154 – 0.277 |
| Mk. Cap. (RONm) | | | 23.34 |
| Free float (%) | | | 17.5 |
| **Performance (%)** | **1m** | **3m** | **12m** |
| Ordinary shares | 0.0 | 6.4 | 24.3 |
| BET | 3.1 | 13.4 | 7.0 |

| Financial data (RON) | 2009 | 2010p | 2011e | 2012e |
|---|---|---|---|---|
| Operating revenues (m) | 154.9 | 182.8 | 200.3 | 217.3 |
| Net profit (m) | 0.9 | 1.8 | 1.7 | 2.7 |
| CFO | 0.104 | 0.037 | (0.013) | 0.042 |
| EPS | 0.009 | 0.017 | 0.016 | 0.025 |
| BVPS | 0.242 | 0.256 | 0.269 | 0.289 |
| Gross Dividend | 0.003 | 0 | 0.002 | 0.005 |
| Payout(%) | 34.7 | 0 | 15.0 | 20.0 |
| Net debt/equity (%) | 33.2 | 15.8 | 30.9 | 24.1 |

| Ratios | 2009 | 2010p | 2011e | 2012e |
|---|---|---|---|---|
| P/E (x) | 25.4 | 12.9 | 13.7 | 8.8 |
| P/CFO (x) | 2.1 | 6.0 | na | 5.2 |
| P/Sales (x) | 0.2 | 0.1 | 0.1 | 0.1 |
| P/B (x) | 0.9 | 0.9 | 0.8 | 0.8 |
| EV/EBITDA (x) | 4.4 | 5.2 | 5.3 | 4.2 |
| EV/EBIT (x) | 6.2 | 7.8 | 9.3 | 6.6 |
| Dividend yield (%) | 1.4 | 0.0 | 1.1 | 2.3 |
| ROIC/WACC (x) | na | na | 0.9 | 1.1 |

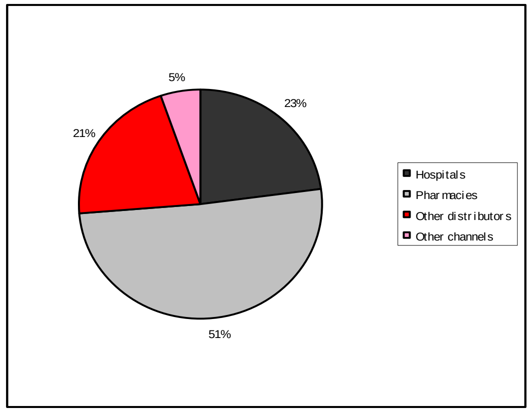
# Company anatomy – business overview

**Sales breakdown retail/distribution 2006 – 9M'10 (RON m)**



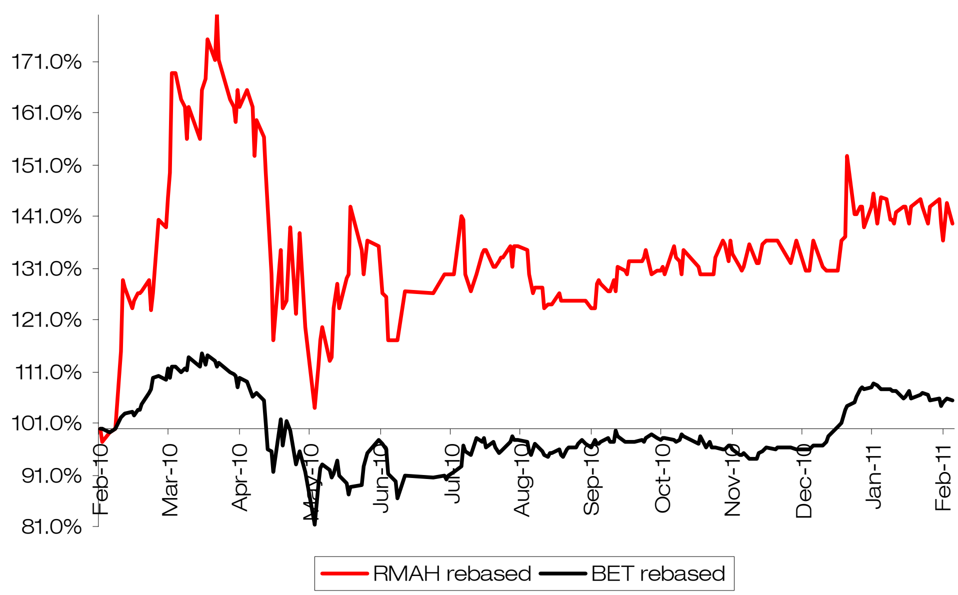

Source: Remedia

**Distribution clients structure as of September 2010**




Source: Remedia

**RMAH vs. BET share price performance**




Source: Reuters, BRD GSG

# Investment summary

## Main arguments for our recommendation

### BRD GSG view

We initiate our coverage on Remedia stock with a Hold recommendation sustained by the results of our employed DCF method and peers valuation, but also by a series of qualitative factors. The DCF valuation results offers a modest upside form currents stock price, while the relative comparison revealed comfortable discounts against its regional peers for the majority of Remedia 's analyzed multiples. On the negative side we reiterate the sector problems, i.e. the liquidities shortage which recently forced the exit from the market of two top ten distributors and small regulated gross margin for distribution and retail pharmaceutical activities. Still, on the short run the price could be sustained by Remedia's buy back shares programme initiated in August 2010 for a period of 12 months. The company's shareholders approved the acquisition of 1.75m shares (1.65% of Remedia share capital) at a price between RON 0.1 and RON 0.5. Until 25 February 2011 the company had already bought back 0.55m shares i.e. 31.3% of the planned amount at an average price of RON 0.2.

Remedia is a medium size player on pharmaceutical distribution market ranking 16$^{th}$ place with 1.08% market share at end June 2010 according to Cegedim data and a regional player on the retail pharmaceutical market having 50 outlets located in the west part of Romania in four neighbour counties. Although the distribution business remained predominant, it lost some weight in the favour of retail segment in the last four years (from 77% of total sales in 2006 to 63% at end September 2010) as a consequence of a more accelerated retail expansion (pharmacies chain almost doubled from 27 units in 2005 to 50 in 2010).

On medium run, the company's main trigger is the expansion of sales especially on the retail side which could bring scale economies and improved profit margins. The company targets a top ten position in distribution segment and also plans to benefit of profitable acquisition opportunities on the retail side.

On the long run, the company should benefit of the convergence process between Romanian pharmaceutical market and EU average in terms of healthcare expenditure per capita, drugs expenditure per capita and increase of preventive drugs consumption, including OTC and nutritive supplements. Currently Romanian market hovers around half of EU average both in terms of drugs sales per capita (EUR 125 vs. EU average EUR 330) and health expenditure as percentage of GDP (4.6% vs. EU average of 8.8%).

### Summary valuation

We valued Remedia using a two stages DCF model. Our model derived a fair price of RON 0.198, leading to a 12M target price of RON 0.23. We explicitly forecast FCFF for the period 2011-2015 based on company's guidance, market and macroeconomic trends and in house forecasts. FCFF were discounted to a variable WACC for 2011-2015 period, ranging between 13.7% and 12.5% in order to reflect Romanian particular macro environment. For the terminal period we used a WACC of 12.1% and a long term growth rate of 2.5%, taking into account the large gap between Romanian pharmaceutical market and European average under the conditions of convergence process. Alternatively, we conducted a relative valuation using a peers group from Europe. At current price (RON 0.220 as of 3 March 2011) Remedia looks cheap in terms of P/E (-13.9% in 2012), EV/EBITDA (-37.8% in 2011 and -44.9% in 2012) and EV/EBIT (-16.1% in 2011 and -28.7% in 2012).

# Other investments considerations

## Alternative scenarios and risks

We consider our valuation results could be affected by a series of macroeconomic, industry and issuer's specific risks:

Macroeconomic risks:

- Slow economic recovery implying deteriorated consumer purchasing power and consequently lower out of pocket drugs consumption;
- higher FX volatility with negative influence on acquisition costs for imported drugs;
- increase of investors risk aversion to Romanian assets driven by poor macroeconomic fundamentals;

Sector risks:

- regulatory risk is significant as pharma market is highly regulated (including changes to prices regime, conditions for authorisation of pharmacies and pharma distributors, changes related to the reimbursed drugs programme, changes regarding public healthcare system – e.g. hospitals reorganisation);
- limited growing potential of the retail chain because of specialised personnel deficit (pharmacists);
- liquidities shortage which is spread over the whole industry because of overdue public debts to drugs producers and healthcare services providers;
- limited gross margin as prices for prescription drugs are capped by the Ministry of Health which establishes maximum margins for pharma distributors and retailers;

Issuer's risk:

- the company is practically controlled by a sole individual which is the majority shareholder and president of the Board of Directors;
- as a medium size player, Remedia could be an acquisition target for larger distributors.

# Company overview

Remedia was set up back in 1991 as a state owned company acting in wholesale (distribution) and retail sale of pharmaceutical products. The company was privatized in 2000 when V.Tarus RoAgencies S.R.L, a company acting in the import and distribution of drugs, bought 55.8% stake. In 2006, Remedia merged with V.Tarus RoAgencies S.R.L. and the owner of the later, Mr. Tarus Valentin Norbert, became majority shareholder of the new company with 85.76% stake. During the last years the majority shareholder sold part of the shares and reduced the controlling stake to 66.06%. Remedia shares have been traded on Rasdaq market since 1996 and have been transferred to main BSE market tier 2 starting with 5 February 2009.

Remedia acts on two segments of Romanian pharmaceutical market: wholesale (distribution) and retail. The company operates eight warehouses located mainly in the central and western part of Romania (i.e. Bucuresti, Deva, Craiova, Tg. Mures, Timisoara, Brasov, Pitesti and Targoviste) and ranked the 16th place in top pharma distributors at the end June 2010 with 1.08% market share (Cegedim data). The retail network includes 50 pharmacies located in four counties in the west part of Romania, i.e. Hunedoara, Alba, Sibiu and Timis.

Remedia sales the whole range of pharmaceutical products: patented Rx drugs, generic Rx drugs, OTC drugs, nutritive supplements and other products (baby products, antiseptic products, medical accessories, cosmetics and hygiene products). Although the sales of distribution segment were the main revenues driver, we noted a decline of this segment in the last years (from 77% in 2006 to 63% in 9M'10) as a consequence of an accelerated expansion of own retail chain and a more restricted clients policy selection in an attempt for mitigating the default risk.

# Key drivers

## Market positioning

On the distribution segment, Remedia is a medium size player with a 1.08% market share at end June 2010 (16th place). Remedia has eight warehouses located mainly in the central and western part of Romania.

On the retail segment, Remedia is also a medium size player (considering the number of pharmacies) with 50 units located mainly in the western part of Romania. Remedia ranks the tenth place as number of operated units.

## Strategic plans

In the last five years, Remedia retail chain almost doubled from 27 pharmacies in 2005 to 40 units in 2007 and 50 in 2010. We don't' expect the growing pace to maintain at the same level in the next years, because of more difficult economic conditions and we are referring here especially at the liquidities crisis of the public healthcare system and implicitly of the pharmaceutical industry and also because of structural imbalances of the market such as acute deficit of specialized personnel (pharmacists). However, according to company's management, Remedia plans to benefit of any market opportunities that could appear, such as the possibility of acquiring independent pharmacies with payment difficulties.

The distribution segment also developed from 6 warehouses with sales of RON 62m in 2006 to 8 units with sales of RON 103m in 2009 (16.3% CAGR 2006-2009). In December 2008 the main warehouse from Bucharest was completely modernized following an investment of EUR 3.3m. The company targets a top ten position on the distribution segment.

Because the gross distribution and retail margin in pharmaceutical industry are regulated by the state and currently capped at 14% and 24% respectively the main trigger for company's improved performance is the growth of sales though expansion of the network and higher sales per operated unit which will also bring scale economies and higher discounts from producers.

# Financials overview

Remedia's sales increased steadily during 2006 -2010 by a CAGR of 21.2% to RON 182.6m in 2010 (preliminary data), reflecting the business expansion. The sales' advance slowed down during 2008 – 2010, but maintained a solid 16% annual growth fuelled mainly by retail chain development. Thus, retail sales increased in line with the development of pharmacies chain. Considering the breakdown retail/ wholesale at end September 2010 (37%/63%), we estimate retail sales reaching from RON 26.2m in 2006 to RON 67.5m in 2010 (36.4% CAGR 2006-2010). We asses that distribution sales which in 2006 represented 77% of company's turnover (RON 65.32m) reached RON 115m in 2010 representing 63% of total sales (15.2% CAGR). The increased stake of retail segment over the wholesale business was a consequence of a more accelerated expansion of the former, but also of a management strategy regarding the mitigation of default risk. The company applied a more restricted clients' policy selection and inclusive ended contracts with clients having payment difficulties.

The company's gross margin gradually improved from 15.2% in 2006 to 21.9% in 2009 and then slightly slipped to 19.1% in 2010 due to better conditions negotiated with drugs producers and direct importers and higher discounts received in line with higher acquired volumes. Operating profitability also improved but remained at modest levels being limited by the regulated cap gross margin for drugs distributors and retailers. (EBIT margin increased from 0.3% in 2007 to 3.3% in 2009 and then came down to 1.9% in 2010). The bottom line had the most volatile path as the financial result either overstated the net profit (3.8% net margin in 2006) or hampered the final result (net margin of -2.3% in 2008 and 0.6% in 2009). The high influence of financial items over the company's results is a consequence of significant pay receivables (46% of annual acquisition values) and financial liabilities (financial leasing) expressed in foreign currencies, especially EUR. Starting with the spring of 2009 the effect was partially mitigated by the new regulations which established fixed exchange rates for imported drugs. Thus in 2010 the influence of the financial items decreased significantly and net margin came at 1%.

Regarding the working capital needs, Remedia exhibited the same pattern as other players in the industry with increased turnover ratios for account receivables which reached 158 days in 2010 (compared with 132 days in 2009 and 113 days in 2008) and for account payables amounting to 180 days in 2010 (from 151 days in 2009 and 168 in 2008). However, indebtedness ratios slightly improved on the back of an extension of suppliers' payment period (debt/equity declined to 50.6% in 2010 from 52.6% in 2009 and 53.5% in 2008).

# Valuation

## Target price calculation and fundamental valuation

We used a fundamental valuation approach by constructing a two stages DCF model, with a first explicit period of five years (2011-2015) and a mature growth period. Our estimates for the explicit period are based on company's guidance, market and macroeconomic trends and in house forecasts. For sales forecast we used Romanian pharmaceutical market forecasts of Business Monitor International and we conservatively considered Remedia will grow slightly below the market. We expect the gross margin to maintain a fairly linear pattern around 19% during 2010-2015. We also expect receivables turnover to decrease to 140 days by 2015 and accounts payable days to reach 155, while inventory days will rather remain around the current values. As regarding capital expenditure we incorporated annual investments in equipments (cars fleet and pharmacies equipment) of RON 2.2m in average during 2011-2015 period.

Our FCFFs of the explicit period were discounted using a variable WACC between 13.7% and 12.5% implying a risk free rate of 7% during 2011-2012 period and 6.5% during 2013-2015, a market risk premium of 7.5% for 2011-2012 and 7% for 2013-2015 and a beta of 1 determined as average beta for the peers group used in relative valuation approach. For the terminal period we used a WACC of 12.1% and a long term growth rate of 2.5%.

**Table 1**

FCFF assumptions & results

| Indicator (RONm) | 2011e | 2012e | 2013e | 2014e | 2015e |
|---|---|---|---|---|---|
| **EBIT** | **3.46** | **4.65** | **6.23** | **8.01** | **9.26** |
| EBIT*(1-t) | 2.91 | 3.90 | 5.23 | 6.73 | 7.78 |
| +D&A expenses | 2.60 | 2.73 | 2.45 | 1.95 | 1.95 |
| - CAPEX | -2.50 | -2.50 | -2.00 | -2.00 | -2.00 |
| - change in Working Capital | -5.79 | -1.18 | -1.21 | -1.14 | -4.84 |
| FCFF | -2.78 | 2.95 | 4.47 | 5.54 | 2.89 |
| **WACC** | **13.7%** | **13.6%** | **12.6%** | **12.6%** | **12.5%** |
| Discounted FCFF | -2.50 | 2.33 | 3.14 | 3.46 | 1.61 |
| Present value of FCFFs | 8.04 | | | | |
| Terminal value | 30.98 | | | | |
| Firm fair value | 25.30 | | | | |
| (-) net debt (Dec'09) | 4.27 | | | | |
| Equity value | 21.03 | | | | |
| Fair value per share | 0.198 | | | | |
| **Target price 12M** | **0.230** | | | | |
| Closing Price as of | 0.22 | | | | |
| **Upside/downside potential** | **4.32%** | | | | |

Source: BRD GSG estimations

At the current market price of RON 0.22 our target price offers a potential upside of 4.3% leading to a **Hold** recommendation.

## Sensitivity

We conducted a sensitivity analysis on WACC and g which lead to the conclusion that our fair price is influenced by both of them: a variation of one percentage point in WACC determined a variation of 4.7-5% of our fair value, while a change of 50 bps in g lead to a volatility of 4.5-5% in fair value.

**Table 2**

Fair value per share sensitivity to WACC and g

| g/WACC | WACC-2% | WACC-1% | WACC | WACC+1% | WACC+2% |
|---|---|---|---|---|---|
| **1.5%** | 0.2001 | 0.1905 | 0.1813 | 0.1726 | 0.1643 |
| **2%** | 0.2088 | **0.1988** | **0.1893** | **0.1803** | 0.1717 |
| **2.5%** | 0.2184 | **0.2080** | **0.1982** | **0.1888** | 0.1798 |
| **3%** | 0.2291 | **0.2183** | **0.2080** | **0.1982** | 0.1888 |
| **3.5%** | 0.2411 | 0.2297 | 0.2189 | 0.2087 | 0.1989 |

Source: BRD GSG estimations

## Other valuation methodologies

We conducted a relative valuation by comparing Remedia price multiples with the means of a selected peers group of companies acting in pharmaceutical sector in Poland and Ropharma, the second BSE listed pharma distributor and retailer. Farmacol SA, Polska Grupa Farmaceutyczna SA and Neuca SA are three Poland based companies engaged in activities such as distribution and retail of pharmaceuticals, medical and rehabilitation equipment, herbal preparations and cosmetics. The relative valuation shows Remedia trades at comfortable discounts against its peers for EV/EBITDA and EV/EBIT and smaller ones for P/E.

## Table 3

Peers valuation

| Company | Ticker | Mk cap EUR m | P/E | | EV/EBITDA | | EV/EBIT | | P/SALES | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 |
| Farmacol SA | FCOL.WA | 208.58 | 8.3 | 7.9 | 6.2 | 5.9 | 6.9 | 6.5 | 0.1 | 0.1 |
| POLSKA GRUPA FARMACEUTYCZNA SA | MDIC.WA | 164.41 | 10.4 | 9.5 | 8.0 | 7.1 | 10.1 | 9.0 | 0.1 | 0.1 |
| Neuca SA | TORF.WA | 91.77 | 8.6 | 7.7 | 7.7 | 6.9 | 10.0 | 8.8 | 0.1 | 0.1 |
| Ropharma | RPHR.BX | 56.31 | 21.7 | 15.8 | 12.2 | 10.3 | 17.2 | 12.8 | 0.6 | 0.5 |
| **Average** | | **130.27** | **12.27** | **10.23** | **8.54** | **7.56** | **11.08** | **9.27** | **0.22** | **0.20** |
| **Median** | | **128.09** | **9.51** | **8.70** | **7.85** | **7.01** | **10.08** | **8.88** | **0.13** | **0.12** |
| **Remedia** | **RMAH.BX** | **5.55** | **13.71** | **8.81** | **5.31** | **4.17** | **9.29** | **6.61** | **0.12** | **0.11** |
| **Premium/Discount** | | | **11.8%** | **-13.9%** | **-37.8%** | **-44.9%** | **-16.1%** | **-28.7%** | **-47.0%** | **-47.6%** |

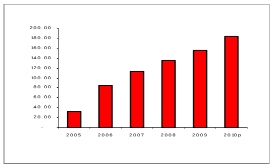
Source : Reuters, BRD estimations

Pharma(Romania) | Price (03/03/2011) | 12m target

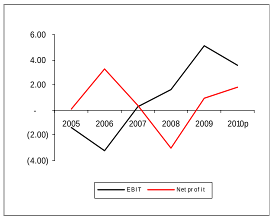
# REMEDIA

**HOLD** | **RON 0.22** | **RON 0.23**

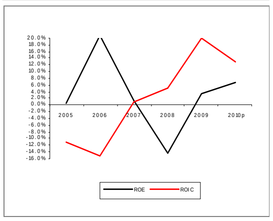
**Operating revenues (RON m)**




**EBIT and net profit (RON m)**




**ROE and ROIC evolution (%)**




**Major shareholders (%)**

| | |
|---|---|
| Tarus Valentin | 66.06 |
| AHG VERMOGENSVERWALTUNGS GESMBH COTTBUS DEU | 16.5 |

| Valuation* (RON m) | 2008 | 2009 | 2010p | 2011e | 2012e | 2013e | 2014e |
|---|---|---|---|---|---|---|---|
| Average nb of shares (diluted) | 106.1 | 106.1 | 106.1 | 106.1 | 106.1 | 106.1 | 106.1 |
| Share price | 0.220 | 0.220 | 0.220 | 0.220 | 0.220 | 0.220 | 0.220 |
| EV | 26.0 | 31.9 | 27.6 | 32.2 | 30.7 | 28.1 | 25.1 |
| P/E (x) | -7.6 | 25.4 | 12.9 | 13.7 | 8.8 | 6.1 | 4.7 |
| P/CFO (x) | -7.6 | 2.1 | 6.0 | -17.5 | 5.2 | 4.4 | 3.9 |
| EV/EBITDA (x) | 7.6 | 4.4 | 5.2 | 5.3 | 4.2 | 3.2 | 2.5 |
| EV/EBIT (x) | 16.1 | 6.2 | 7.8 | 9.3 | 6.6 | 4.5 | 3.1 |
| P/B (x) | 1.1 | 0.9 | 0.9 | 0.8 | 0.8 | 0.7 | 0.6 |
| P/Sales (x) | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Dividend yield | 0.0% | 1.4% | 0.0% | 1.1% | 2.3% | 3.3% | 4.3% |
| **Per share data (RON)** | | | | | | | |
| EPS | -0.029 | 0.009 | 0.017 | 0.016 | 0.025 | 0.036 | 0.047 |
| CFO | -0.029 | 0.104 | 0.037 | -0.013 | 0.042 | 0.050 | 0.057 |
| Book value | 0.200 | 0.242 | 0.256 | 0.269 | 0.289 | 0.318 | 0.355 |
| Dividend | 0.000 | 0.003 | 0.000 | 0.002 | 0.005 | 0.007 | 0.009 |
| **Income statement (RON m)** | | | | | | | |
| Total Operating revenues | 134.6 | 154.9 | 182.8 | 200.3 | 217.3 | 234.6 | 251.0 |
| EBITDA | 3.4 | 7.2 | 5.4 | 6.1 | 7.4 | 8.7 | 10.0 |
| Depreciation, depletion and amort. | -1.8 | -2.1 | -1.8 | -2.6 | -2.7 | -2.4 | -1.9 |
| EBIT | 1.6 | 5.1 | 3.5 | 3.5 | 4.6 | 6.2 | 8.0 |
| Net interest income | -0.4 | -0.4 | -0.3 | -0.8 | -0.6 | -0.4 | -0.4 |
| EBT | -3.1 | 1.3 | 2.8 | 2.6 | 4.1 | 5.9 | 7.7 |
| Corporate tax | 0.0 | -0.4 | -1.0 | -0.9 | -1.4 | -2.1 | -2.7 |
| Net profit | -3.1 | 0.9 | 1.8 | 1.7 | 2.7 | 3.8 | 5.0 |
| **Cash flow statement (RON m)** | | | | | | | |
| Net profit | -3.1 | 0.9 | 1.8 | 1.7 | 2.7 | 3.8 | 5.0 |
| Depreciation, depletion and amort. | 1.8 | 2.1 | 1.8 | 2.6 | 2.7 | 2.4 | 1.9 |
| Change in working capital | 0.1 | -7.2 | 2.6 | -5.8 | -1.2 | -1.2 | -1.1 |
| Cash flow from operating activities | -3.1 | 11.1 | 3.9 | -1.3 | 4.5 | 5.3 | 6.1 |
| Net capital expenditure | -10.8 | -16.5 | -0.6 | -2.5 | -2.5 | -2.0 | -2.0 |
| Cash flow from investing activities | -11.1 | -16.8 | 0.8 | -2.5 | -2.5 | -2.0 | -2.0 |
| Cash flow from financing activities | 3.9 | 2.0 | -0.2 | -2.4 | -4.5 | -3.8 | -1.0 |
| Net change in cash resulting from CF | -10.3 | -3.7 | 4.4 | -6.3 | -2.5 | -0.4 | 3.1 |
| **Balance sheet (RON m)** | | | | | | | |
| Total long-term assets | 24.9 | 27.2 | 26.9 | 26.8 | 26.6 | 26.1 | 26.2 |
| of which tangible | 23.2 | 25.4 | 24.6 | 24.7 | 24.7 | 24.5 | 24.8 |
| Working capital | 3.5 | 10.7 | 8.1 | 13.9 | 15.1 | 16.3 | 17.4 |
| Long term liabilities | 12.7 | 0.9 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| of which long term debt | 11.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Shareholders' equity | 21.3 | 25.7 | 27.1 | 28.6 | 30.7 | 33.7 | 37.7 |
| Net debt (+)/cash (-) | 2.7 | 8.5 | 4.3 | 8.8 | 7.4 | 4.8 | 1.7 |
| **Accounting ratios** | | | | | | | |
| ROIC (%) | 4.7% | 19.3% | 12.8% | 12.1% | 15.1% | 18.5% | 21.2% |
| ROE (%) | -14.4% | 3.6% | 6.7% | 6.0% | 8.6% | 11.3% | 13.2% |
| Sales growth (%) | 22.1% | 15.0% | 18.2% | 9.5% | 8.5% | 8.0% | 7.0% |
| EBITDA margin (%) | 2.5% | 4.7% | 2.9% | 0.0% | 0.0% | 0.0% | 0.0% |
| EBIT margin (%) | 1.2% | 3.3% | 1.9% | 1.7% | 2.1% | 2.7% | 3.2% |
| Net income margin (%) | -2.3% | 0.6% | 1.0% | 0.9% | 1.2% | 1.6% | 2.0% |
| Current ratio (x) | 1.1 | 1.0 | 1.0 | 1.0 | 1.0 | 1.1 | 1.1 |
| Net debt/equity (x) | 0.1 | 0.3 | 0.2 | 0.3 | 0.2 | 0.1 | 0.0 |
| Interest cover (x) | 2.3 | 9.5 | 9.6 | 4.1 | 8.3 | 17.8 | 22.9 |
| Payout ratio (%) | 0.0% | 34.7% | 0.0% | 15.0% | 20.0% | 20.0% | 20.0% |
| ROIC/WACC(%) | na | na | na | 0.9 | 1.1 | 1.5 | 1.7 |

* Valuation rati os for past years are based on current price

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Selected from stocks expected to outperform the market by over 25%.

**Buy**
Expected to outperform the market by at least 10%.

**Hold**
Expected to perform in line with the market +/–10%.

**Sell**
Expected to underperform the market by at least 10%.

**Assumptions**
12 month time horizon and flat market over forecast period.

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