

Sector: Pharmaceuticals
 Fundamental rating: Buy (→)
 Market relative: Overweight (→)
 Price: PLN 47.0
 12M EFV: PLN 59.0 (↑)

Market Cap.: US\$ 202 m
 Reuters code: MDCI.WA
 Av. daily turnover: US\$ 0.16 m
 Free float: 77%
 12M range: PLN 18.65-50.35

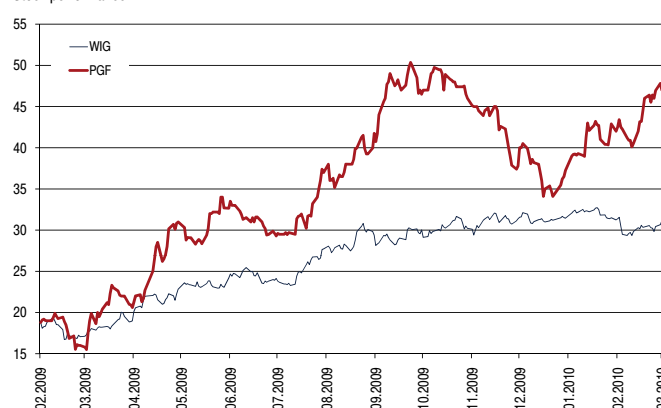
Guide to adjusted profits
 No factors necessitating adjustments.

Key data

IFRS consolidated		2009	2010E	2011E	2012E
Sales	PLN m	5,390.7	5,929.7	6,226.2	6,475.3
EBITDA	PLN m	145.4	143.4	147.5	148.1
EBIT	PLN m	113.8	110.8	113.9	113.4
Net Income	PLN m	65.5	72.2	73.2	73.5
EPS	PLN	5.26	5.71	5.79	5.82
EPS yoy change	%	47	9	1	1
Net Debt	PLN m	455.5	451.5	396.5	367.0
P/E	x	8.9	8.2	8.1	8.1
P/CE	x	6.0	5.7	5.6	5.5
EV/EBITDA	x	7.2	7.3	6.7	6.5
EV/EBIT	x	9.1	9.4	8.7	8.5
Gross dividend yield	%	0.0	3.3	3.6	6.2
Number of shares (eop)	ths.	12,460	12,645	12,645	12,645

Source: Company, DM IDMSA estimates

Stock performance



Source: ISI

Upcoming events

1. Release of FY09 audited consolidated results: April 30, 2010
2. Release of 1Q10 consolidated results: May 14, 2010

Catalysts

1. Pharmaceutical market development
2. Strengthening of PLN vs. Euro
3. Acquisition projects – CEPD development

Risk factors

1. Regulatory risk (any changes in the pharmaceutical regulations)
2. Currency risk (due to some payments in EUR)
3. Interest rate risk (very limited due to low debt)
4. Development of parallel imports
5. Logistic centers
6. Situation on the foreign markets due to investments abroad

4Q09 financial results – some afterthoughts. PGF's 4Q09 results (released on March 1, before the session) were decent at the top line level, which increased by 13% yoy. It means that the Company managed to overcome difficulties connected with implementation of a new bonus scheme. The reported yoy and qoq growth of general administration and selling costs was significant in 4Q09; however, it stemmed from improper allocation of S&G costs in previous quarters, and – as a result – elevated costs in 4Q09. As a result, the profit on sales calculated on the basis of 4Q09 figures is meaningless in forecasting the profitability in the next quarters. The Company recognized net other operating income of PLN 36 million in 4Q09 vs. PLN 25 million in 4Q08. PGF accounted for sales lease-back transaction in Kraków and NDS Depo disposal in 4Q09. As a result of the aforementioned one-off events, the Company reported 4Q09 EBIT at PLN 46 million, much above our forecast of PLN 35 million and the market consensus of PLN 30 million. Although the Company's net financial costs were slightly lower than we expected, the effective income tax rate was, similarly to the preceding quarters, much higher than the statutory one (whereas we assumed it at a lower level). As a result, PGF's 4Q09 consolidated NP was in line with forecasts.

The Company's management guidance for this year. PGF's management expects 6-7% yoy growth of the pharmaceutical market this year. Although poor January's data, with a mere 5% yoy growth of the pharmacies market (according to IMS Health), might be perceived as a bad omen, it should be remembered that there were two months with a marvellous market growth last year – January and November, which means that base month figures are extremely high. Moreover, due to severe winter the access to health centres was difficult and a number of seasonal infections was lower yoy. Thus, despite poor pharmacies market growth figure in January 2010, the annual growth forecast has been maintained – according to PMR the growth of the pharmacies market will reach c. 7% yoy this year.

Based on the aforementioned forecast of the pharmaceutical market dynamics, PGF's management project the consolidated top line of the Company at PLN 6 billion in FY10, 11% up yoy. Such sales dynamics should allow to deliver a double-digit yoy NP growth, however more likely close to 10% than 20%. 10% yoy NP growth would imply PGF's NP in FY10 at PLN 72 million. Moreover, despite realisation of options on Aptekarz and Lithuanian entities, the Company's consolidated ND is projected not to exceed PLN 500 million at the end of 2010 (vs. PLN 456 million at the end of 2009).

Revision of our financial forecasts. Given 2H09 sales dynamics, it seems likely that the Company's top line will exceed growth of the pharmacies market, especially in 1H10, also due to poor last

year base. Thus, we increase our top line forecasts for this year – we forecast 7% yoy sales growth at PGF (to PLN 5.9 billion). The crucial question lies in the profitability assumptions. First of all, we believe that last year costs were elevated by some additional items connected with the restructuring processes (with

positive one-offs in 4Q09, the Company might have sped up some processes generating costs). Thus, there should be visible improvement at the cost ratios this year – the restructuring effects should appear, and an employment reduction should be visible. Moreover, the profitability of the retail arm, although it went up from 2.1% in 2008 to 2.7% in 2009, is still far from the targeted level. Additionally, changes in the sales mix, with faster development of the retail arm (where reported EBIT margin is above that of the wholesale segment: 2.7% vs. 1.6%), should support the consolidated margins. Finally, the Company's management claims that the organisational structure of PGF is ready to absorb fast sales development, which means that finally the scale effects should appear. Thus, we would expect improvement of the profitability on the core business this year. The Company's management bottom line forecast for FY10 implies massive improvement, however realistically we do believe that some one-off transactions will also appear in 2010. Nevertheless, according to the Company's management, they will be lower than last year. The Company has prepared three wholesales for the sale this year. Additionally, some sales lease-back transactions might appear. Thus, we forecast the net other operating profit at PLN 25 million in FY10 and project that the management's targets for this year will be met. In fact, we do believe that the

Company might make some bottom line supporting transactions, if the restructuring process of the retail arm is to be slow or the sales development does not allow to reach expected scale effects, in order to meet the forecasts. Regarding the details of our forecasts revision, please refer to *Figure 2*.

12M EFV up. The aforementioned upward revision of our financial forecasts for the Company and forward shift of the valuation horizon results in 12M EFV for PGF at PLN 59.0 per share, up from PLN 55.4 per share previously (6% increase).

Buy + Overweight. Our upgraded 12M absolute-value-based EFV rests well above the current market price. Moreover, the Company's management forecasts for FY10 imply quite a nice NP at PLN 72 million (c. 8x P/E). With one-off events lower yoy in 2010E, it must mean an improvement of the profitability on core activities, which in turn would be welcomed by the financial community. Thus, we reiterate our LT-fundamental Buy recommendation for the Company's shares. We also maintain our Overweight ST market-relative stance vs. PGF's shares, as we expect the following quarters to bring yoy growth at PGF's bottom line and profit on sales levels.

BASIC DEFINITIONS

A/R turnover (in days) = $365/(\text{sales}/\text{average A/R})$

Inventory turnover (in days) = $365/(\text{COGS}/\text{average inventory})$

A/P turnover (in days) = $365/(\text{COGS}/\text{average A/P})$

Current ratio = $(\text{current assets} - \text{ST deferred assets})/\text{current liabilities}$

Quick ratio = $(\text{current assets} - \text{ST deferred assets} - \text{inventory})/\text{current liabilities}$

Interest coverage = $(\text{pre-tax profit before extraordinary items} + \text{interest payable})/\text{interest payable}$

Gross margin = $\text{gross profit on sales}/\text{sales}$

EBITDA margin = $\text{EBITDA}/\text{sales}$

EBIT margin = EBIT/sales

Pre-tax margin = $\text{pre-tax profit}/\text{sales}$

Net margin = $\text{net profit}/\text{sales}$

ROE = $\text{net profit}/\text{average equity}$

ROA = $(\text{net income} + \text{interest payable})/\text{average assets}$

EV = $\text{market capitalization} + \text{interest bearing debt} - \text{cash and equivalents}$

EPS = $\text{net profit}/\text{no. of shares outstanding}$

CE = $\text{net profit} + \text{depreciation}$

Dividend yield (gross) = $\text{pre-tax DPS}/\text{stock market price}$

Cash sales = $\text{accrual sales corrected for the change in A/R}$

Cash operating expenses = $\text{accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes}$

DM IDM S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:

Buy – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;

Hold – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;

Sell – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

Overweight – expected to perform better than the benchmark (WIG) over the next quarter in relative terms

Neutral – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms

Underweight – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM IDMSA's recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first. Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

Banks

Net Interest Margin (NIM) = $\text{net interest income}/\text{average assets}$

NIM Adjusted = $(\text{net interest income adjusted for SWAPs})/\text{average assets}$

Non interest income = $\text{fees\&commissions} + \text{result on financial operations (trading gains)} + \text{FX gains}$

Interest Spread = $(\text{interest income}/\text{average interest earning assets})/(\text{interest cost}/\text{average interest bearing liabilities})$

Cost/Income = $(\text{general costs} + \text{depreciation} + \text{other operating costs})/(\text{profit on banking activity} + \text{other operating income})$

ROE = $\text{net profit}/\text{average equity}$

ROA = $\text{net income}/\text{average assets}$

Non performing loans (NPL) = loans in 'substandard', 'doubtful' and 'lost' categories

NPL coverage ratio = $\text{loan loss provisions}/\text{NPL}$

Net provision charge = $\text{provisions created} - \text{provisions released}$

DM IDM S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation.

Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc.

Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

LT fundamental recommendation tracker

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)	
PGF									
Buy	-	21.02.2008	-	17.08.2008	-27%	-12%	81.90	95.3	-
-	→	-	03.03.2008	-	-	-	76.00	88.8	↓
-	→	-	30.03.2008	-	-	-	74.95	89.1	↑
-	→	-	24.04.2008	-	-	-	79.50	90.2	↑
-	→	-	29.04.2008	-	-	-	80.20	90.2	→
-	→	-	19.05.2008	-	-	-	77.80	87.8	↓
-	→	-	01.06.2008	-	-	-	67.00	87.8	→
-	→	-	13.07.2008	-	-	-	54.55	77.8	↓
Hold	↓	17.08.2008	-	17.05.2009	-52%	-34%	59.55	72.3	↓
-	→	-	31.08.2008	-	-	-	54.70	72.3	→
-	→	-	28.09.2008	-	-	-	40.80	72.3	→
-	→	-	21.10.2008	-	-	-	32.00	51.7	↓
-	→	-	29.10.2008	-	-	-	23.50	51.7	→
-	→	-	23.11.2008	-	-	-	27.80	40.7	↓
-	→	-	30.11.2008	-	-	-	27.99	40.7	→
-	→	-	11.01.2009	-	-	-	26.20	40.7	→
-	→	-	04.02.2009	-	-	-	19.19	33.6	↓
-	→	-	08.02.2009	-	-	-	19.00	33.6	→
-	→	-	08.03.2009	-	-	-	19.88	33.6	→
-	→	-	05.04.2009	-	-	-	22.01	33.6	→
Buy	↑	17.05.2009	-	Not later than 17.05.2010	66%	23%	28.35	33.6	→
-	→	-	18.05.2009	-	-	-	29.39	40.3	↑
-	→	-	08.06.2009	-	-	-	32.30	40.3	→
-	→	-	08.07.2009	-	-	-	29.45	40.3	→
-	→	-	26.07.2009	-	-	-	33.20	40.30	→
-	→	-	02.08.2009	-	-	-	37.00	40.30	→
-	→	-	31.08.2009	-	-	-	39.95	40.30	→
-	→	-	12.10.2009	-	-	-	49.48	40.30	→
-	→	-	20.10.2009	-	-	-	48.20	55.40	↑
-	→	-	14.12.2009	-	-	-	38.00	55.40	→
-	→	-	07.01.2010	-	-	-	39.10	55.40	→
-	→	-	03.02.2010	-	-	-	43.40	55.40	→
-	→	-	01.03.2010	-	-	-	47.80	55.40	→
-	→	-	02.03.2010	-	-	-	47.00	59.00	↑

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
PGF						
Neutral	-	21.02.2008	-	29.04.2008	81.9	5%
-	→	-	03.03.2008	-	76	-
-	→	-	30.03.2008	-	74.95	-
-	→	-	24.04.2008	-	79.5	-
Underweight	↓	29.04.2008	-	01.06.2008	80.20	-17%
-	→	-	19.05.2008	-	77.8	-
Neutral	↑	01.06.2008	-	17.08.2008	67.00	1%
-	→	-	13.07.2008	-	54.55	-
Underweight	↓	17.08.2008	-	11.01.2009	59.55	-35%
-	→	-	31.08.2008	-	54.70	-
-	→	-	28.09.2008	-	40.80	-
-	→	-	21.10.2008	-	32	-
-	→	-	29.10.2008	-	23.50	-
-	→	-	23.11.2008	-	27.8	-
-	→	-	30.11.2008	-	27.99	-
Neutral	↑	11.01.2009	-	04.02.2009	26.20	-13%
Overweight	↑	04.02.2009	-	07.01.2010	19.19	16%
-	→	-	08.02.2009	-	19.00	-
-	→	-	08.03.2009	-	19.88	-
-	→	-	05.04.2009	-	22.01	-
-	→	-	17.05.2009	-	28.35	-
-	→	-	18.05.2009	-	29.39	-
-	→	-	08.06.2009	-	32.30	-
-	→	-	08.07.2009	-	29.45	-
-	→	-	26.07.2009	-	33.20	-
-	→	-	02.08.2009	-	37.00	-
-	→	-	31.08.2009	-	39.95	-
-	→	-	12.10.2009	-	49.48	-
-	→	-	20.10.2009	-	48.20	-
-	→	-	14.12.2009	-	38.00	-
Overweight	→	07.01.2010	-	Not later than 07.01.2011	39.10	24%
-	→	-	03.02.2010	-	43.40	-
-	→	-	01.03.2010	-	47.80	-
-	→	-	02.03.2010	-	47.00	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	20	34	12	1	0
Percentage	30%	51%	18%	1%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	23	29	14	1	0
Percentage	34%	43%	21%	1%	0%

Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking

	Buy	Hold	Sell	Suspended	Under revision
Numbers	1	5	0	1	0
Percentage	14%	71%	0%	14%	0%

Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	1	4	1	1	0
Percentage	14%	57%	14%	14%	0%

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