Selçuk Ecza Deposu A.Ş.

Financial Situation Analysis

Case Report

Yağmur Asuman Çubukçu
Gupse Taş
Burkay Fuat Ercan
İbrahim Hasan Çelik
Furkan Işık

Executive Summary

This report provides an analysis and evaluation of the current financial situation of the Selçuk Ecza Deposu A.Ş. by analyzing company's financial statements. Methods of analysis include ratio analysis, industry comparison, trend analysis in capital structure, etc.… all calculations can be found in provided excel sheet. Results of data analysis show that Selçuk Ecza Deposu A.Ş. is efficient in terms of inventory management, profit margins, and high potential of prospective future performance. In the report, income statement, balance sheet and cash flow of the company is examined separately.

Selçuk Ecza Deposu A.Ş. has 16.09% yearly revenue growth, 22.48% yearly EBITDA growth in last five years and 18.88% yearly growth in net profit. Moreover, 13.51% yearly growth in assets and 9.58% yearly equity growth.

Company also has no foreign exchange rate risks and can protect itself from interest rate changes thanks to their accounts receivables which is equal to total debt and group can offset the interest expenses on debts with interest revenues from accounts receivables.

Recommendations discussed include improving the liquidity of the company by effective cost management techniques and the interest coverage ratio by changing the capital structure.

As result of the study, this report recommends investors to buy the company's stocks since our forecast of TTM price of the company's stock price is 5.33 in TL terms, despite the current stock price of 3.9 TL with a potential of 36% expected return.

1. Introduction

The aim of this report is to analyze the financial statements of the Selçuk Ecza Deposu A.Ş. for assessing the financial situation and current position of the company relative to its industry and sector.

2. Company Brief

- Selçuk Ecza Deposu A.Ş. is a pharmaceutical product wholesaler which coordinates drug distribution between pharmaceutical manufacturers and pharmacies and hospitals, also founded in 1970.
- The company is the first pharmaceutical product distributor with multibranch operations in Turkey.
- Selçuk Ecza Deposu A.Ş has lived through and performed successfully during all the political and economic hardships experienced in Turkey and secured its place and reputation among the industry, which is an essential sign of stable growth.
- The company is the oldest and one of the most important participants in its sector.
- The Company has a leading position with 41,64% market share in TL terms and 41,97% in terms of boxes.
- Vision Statement: "As a company operating in a sector where human health is the primary essence, the vision of Selçuk Ecza Deposu is to provide services designed at global standards required by our time for its local and foreign customers at a national and international level, to improve and diversify its services, and to perform even better than what's expected of it when people's well-being is concerned about analyzing all the dynamics of a sector focused on human health."

- Mission Statement: “The mission of Selçuk Ecza Deposu is to maintain its leadership in its industry by analyzing the dynamics of the sector well, maintain its reputation as a reliable organization providing quality services as a point of access between pharmacies and drug suppliers, and provide for the needs, demands and expectations of its customers by offering the widest range of products with the most favorable commercial terms and state-of-the-art technology, in accordance with "Good Distribution Method" principles.”
- A high majority of the company's shares is privately held, and first IPO was made in 2006.
- The shareholding structure can be seen in the figure2.1.

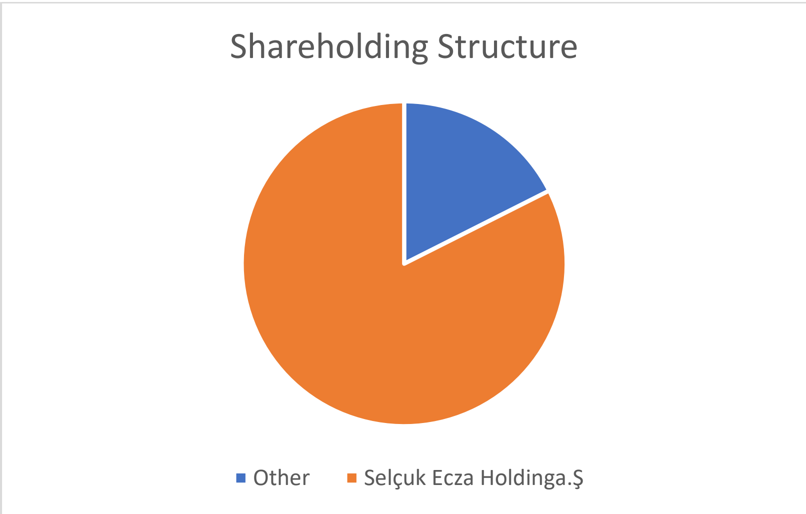
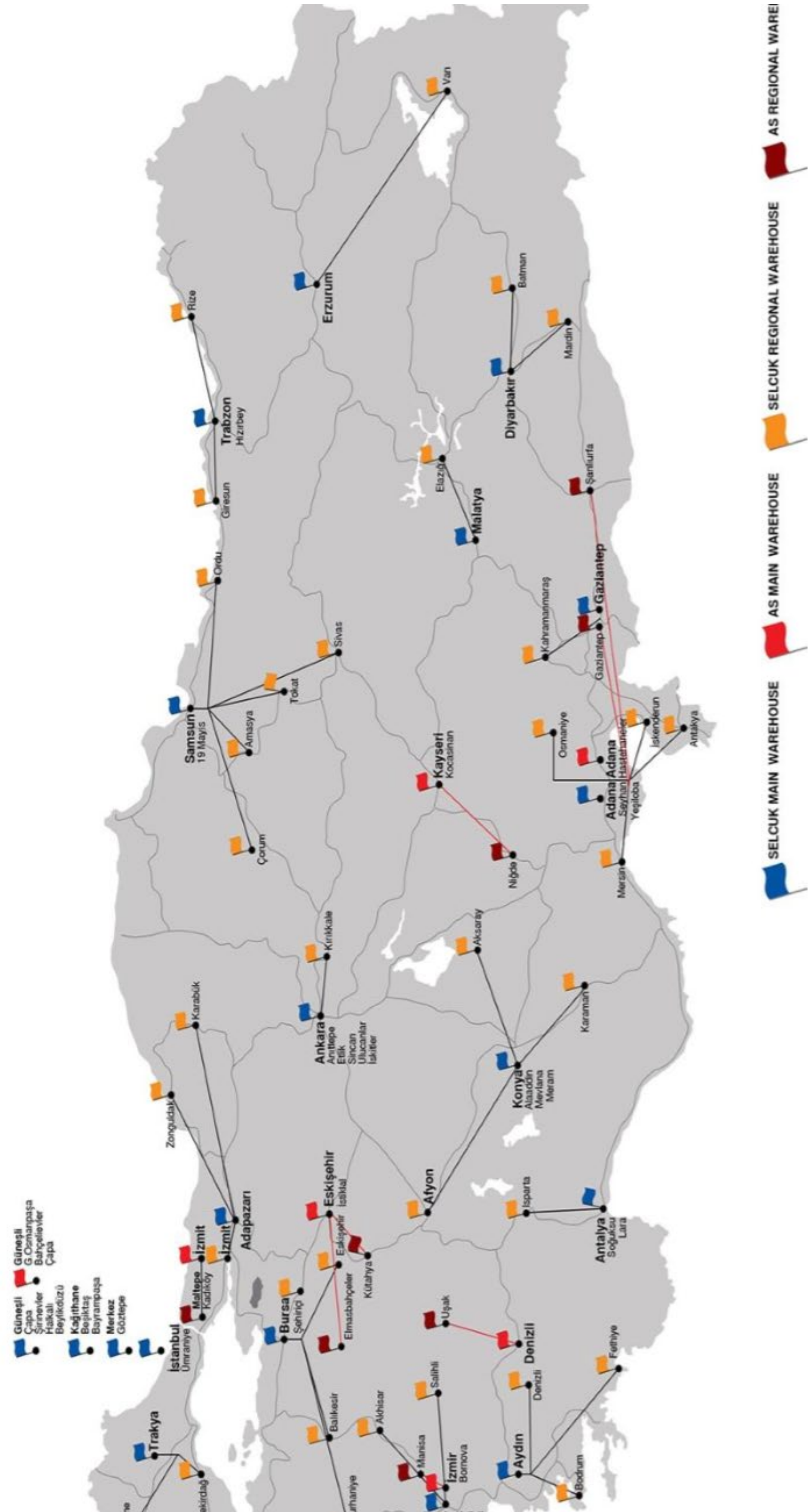


Figure 2.1.

- According to data from yahoo finance, the company operates in the consumer defensive sector and pharmaceutical retailers’ industry.
- Selçuk Ecza Deposu A.Ş has 90 and its warehouse network as can be seen in figure 2.2.

Figure 2.2.



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3. Industry Characteristics

Characteristic features of the pharmaceutical retail industry can be observed from the SWOT analysis below.

<table>
<tr><td>Strengths
Improved structure in terms of production capacity, standards, and technology.
Highly qualified workforce and talented candidates.
Non-cyclical demand.
Almost all of Turkey's pharmaceutical market is reimbursed by the state, and Turkey's pharmaceutical market is very favorable in terms of demographics.</td><td>Weaknesses
Exchange rate fluctuations.
Very high foreign trade deficit.
Licensing process of imported products.</td></tr>
<tr><td>Opportunities
Several indicators show the sector will continue to grow in the coming years
High growth rates of emerging markets in the World.</td><td>Threats
Geopolitical troubles are put pressure on exports.
Effects of change in the regulations.</td></tr>
</table>

Table 3.1.

4. Review and Assessment of the Firm's Financial Statements with Ratios

4.1. Balance Sheet

A balance sheet is an essential tool, for both analysts and companies, and is a snapshot of the financial position of the company on investigation. To gain insight about the Selçuk Ecza Deposu A.Ş. and its operations, common size balance sheet, which can be found in the appendix, was analyzed. Since the asset composition of the company has not changed significantly throughout the years between 2014 and 2018 (Figure 4.1.1), it was investigated from the balance sheet dated at 31.12.2018.

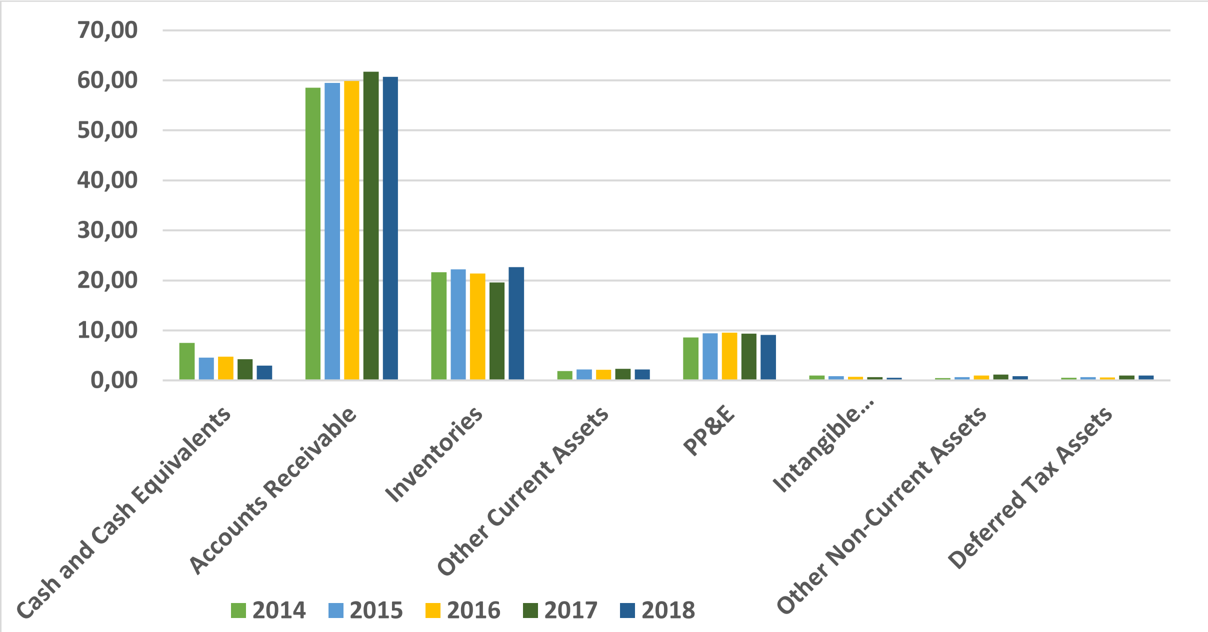

Figure4.1.1

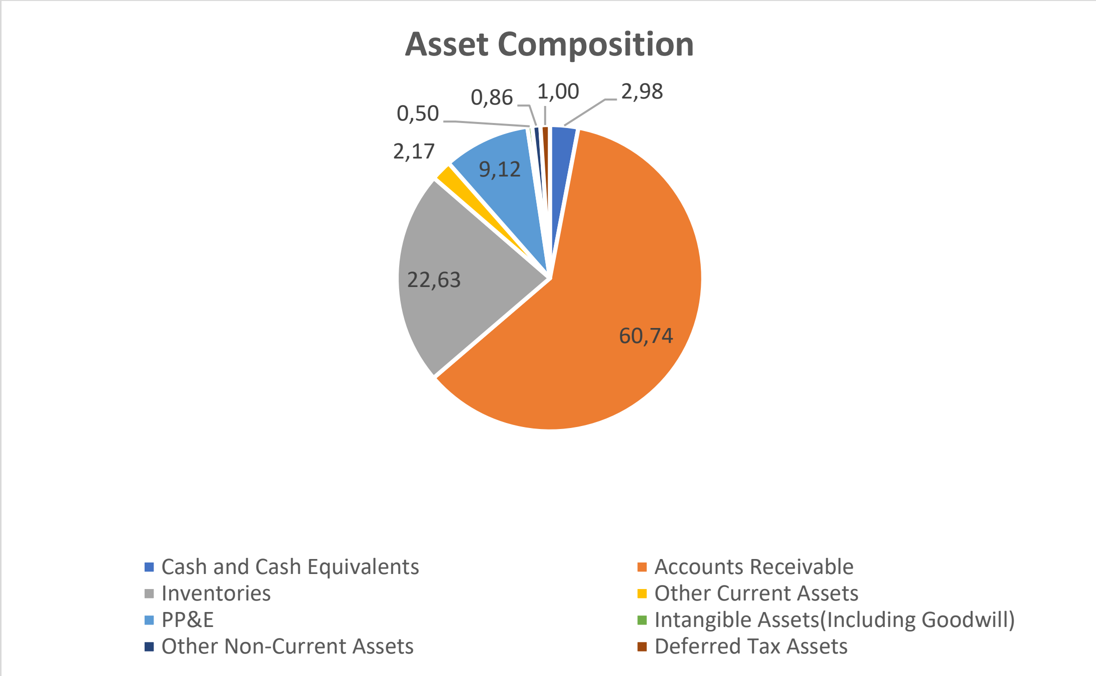

Figure 4.1.2

Account receivable account constitutes the highest portion of the company's assets with 60,74%, which requires further investigation. To asses the quality of the account, related ratios were calculated and analyzed. (Table 4.1.1)

	2015	2016	2017	2018	Industry
Accounts Receivable Turnover	3.50	3.50	3.66	3.81	9.15
Collection Period	103.00	102.81	98.23	94.51	39.34

Table 4.1.1.

Throughout the years between 2015 and 2018, the company had been successful in debt collection by decreasing the collection period, which is a sign of the practical work practices even if the ratios are unable to retort industry average. To be able to ensure the effectiveness of the management, account payable ratio was calculated (Table 4.1.2.). Herewith, account payable account constitutes the highest portion of the current liabilities, with 56.39% of total liabilities and shareholders equity.

	2015	2016	2017	2018
Accounts Payable Turnover	3.79	3.72	3.85	3.89
Payment Period	95.00	96.90	93.55	92.60

Table 4.1.2.

The increasing trend in the account payable turnover shows that Selçuk Ecza Deposu A.Ş is not in financial distress. Also, the company can pay its debts to suppliers in shorter periods, which is a sign of increased cash available in the company. Furthermore, as can be observed from the figure 4.1.3, the collection period of account receivable and payment period of account payable had been converged between 2015 and 2018. This convergence is essential because these accounts have similar risk characteristics and to be able to continue operations at the same level without changing riskiness of the company, duration of this account should match as in the case of the bank's duration gap analysis.

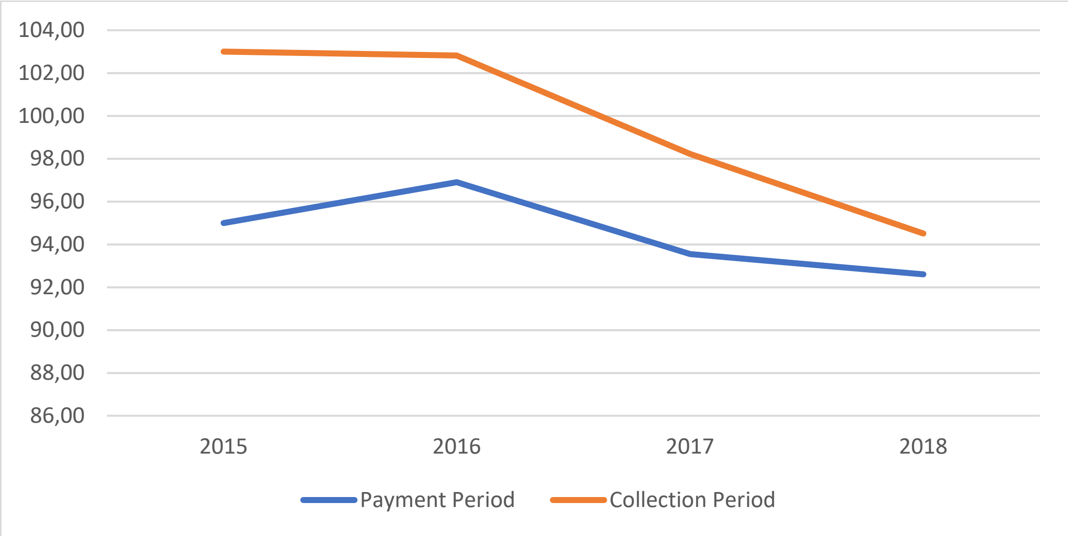

Figure 4.1.3

Secondly, inventories compose around 22% of the company's assets. To analyze the quality of the account, the inventory turnover ratio was calculated and analyzed. (Table 4.1.3). Selçuk Ecza Deposu A.Ş is very successful at managing its inventories, company not only increased its inventory turnover, but also all ratios through the years between 2015 and 2018 are above the industry average, which is also a good sign of effective management practices.

	2015	2016	2017	2018	Industry
Days to sell inventory	41.16	40.59	35.69	35.60	51.28
Inventory Turnover	8.75	8.87	10.09	10.11	7.02

Table 4.1.3

At third, liquidity analysis was made to assess the quality of cash and cash equivalents of the company. (Table 4.1.4) Both the current ratio and quick ratio of the company, throughout the years between 2015 and 2018, followed a negative trend and are below the industry average. Even if these ratios are above the threshold, which is 1, they should be improved by incorporating effective cost management to company practices.

	2014	2015	2016	2017	2018	Industry
Current Ratio	1.69	1.62	1.58	1.54	1.48	1.53
Quick Ratio	1.28	1.21	1.20	1.20	1.10	1.12

Table 4.1.4

Another side of the balance sheet shows us the capital structure of the company, which is important for the solvency analysis of the company. Selçuk Ecza Deposu A.Ş can be considered as not risky thanks to its lower D/E ratio, furthermore company has “0” long-term debt which is good sign for the company that do not make any long-term investments such as R&D investments, but because of the economic conditions of Turkey, the company has been become vulnerable to interest rate risk over time as a result of increase in inflation and interest rate in the market. Thus, burden of debt-expense increased over time as a result of the interest payment of the short-term liabilities, but the interest coverage ratio is still above the threshold point, which is 1.5. (*Figure 4.1.4)*

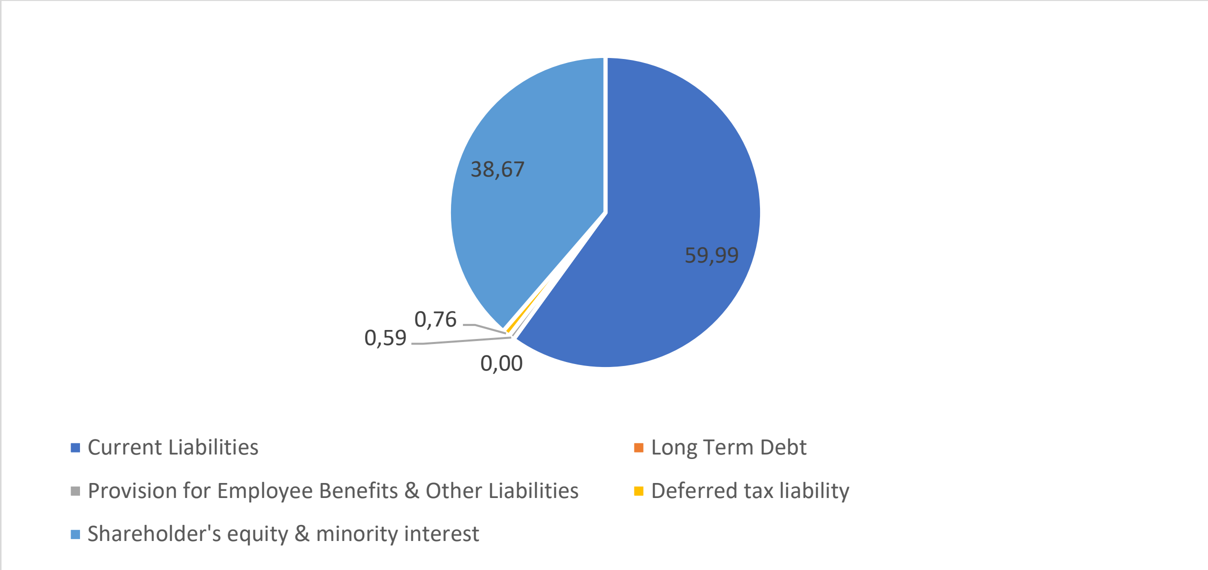

Figure 4.1.4

	2014	2015	2016	2017	2018	Industry
TAT	1.88	1.94	1.96	2.07	2.11	1.59
Total Debt Ratio (Included in short-term debt)	0.54	0.56	0.57	0.58	0.61	
D/E	1.17	1.26	1.32	1.40	1.59	

Table 4.1.5

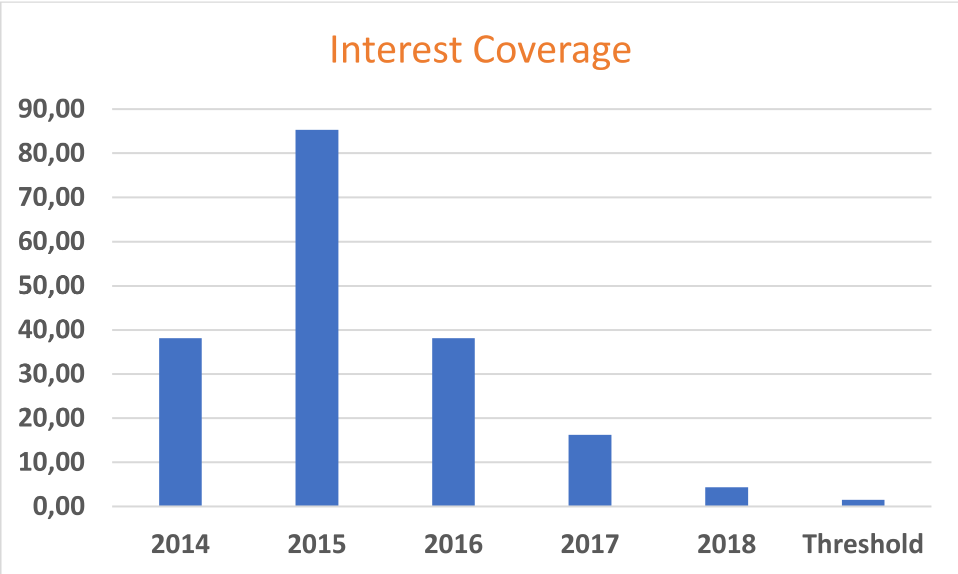

Figure 4.1.5

4.2.Income Statement

Selçuk Ecza Deposu A.Ş. was examined according to its revenues, costs, and ratios related to the income statement. Throughout, five years period, the company had been presented excellent performance by expanding its market share in its sector. Increased gross profit margin from 16.57% to 26.75%, between 2014 and 2018, is an indicator that management had used the company's resources effectively to increase sales while holding costs at an acceptable level. In pharmaceutical product industry, the demand condition is vertical because total demand for medication does not depend heavily on the purchasing power of the public, and one of the least affected industries from fluctuations in the business cycle. Even most of the drugs are imported from foreign countries, increasing exchange rates or decreasing purchasing power will be offset by the need of the public to them.

Therefore, our expectations about the company are positive on the condition that the position of company related to the exchange rate and business mix will not change. Administrative and other operational expenses of the company have followed a parallel trend with the revenue and cost volume of the goods. A large portion of the income statement items is not presenting abnormal fluctuations between 2014 and 2018. However, we observed that other operating activities, income from investing activities, and financial expenses had increased more than 200% from 2017 to 2018. When the composition of these items is examined, it is revealed that the leading cause of change comes from increasing interest rates in Turkey. The company indicates in the footnotes the interest payments of the payables and receivables have shown under the other operating activities item. Thus, a great increase among the TRY/USD exchange rate is the main cause of the rise in other operating activities item. So, we can also say that they hedge the risk of depreciation of Turkish Liras by making agreements based on a floating rate. (usage of floating rates rather than fixed rates is also mentioned in footnotes).

Income from Investing Activities	**01.01-31.12.2018**	**01.01-31.12.2017**
Income from Sale of Fixed Assets	5,391,711.00	3,337,878.00
Time Deposit Interest Payments (Received)	44,681,514.00	8,434,540.00
Income from Leasing Activities	6,021,706.00	4,745,676.00
Total	56,094,931.00	16,518,094.00
Financing Expenses		
Interest Expenses of Short-Term Debt	101,482,632.00	21,171,801.00
Total	101,482,632.00	21,171,801.00

Table 4.2.1

EBIT of the company is higher than operating profit due to profit from investing activities. Between sample years, Selçuk Ecza's investing activities have generated higher revenues compared to its costs. We observe that their general investing activities are much lower than they should be. Moreover, when we analyze the composition of their investments, we saw that the majority of their investing activities between 2016 and 2018 are composed by a time deposit account of the company. Therefore, the increase in revenue of investing activities is caused by the rise in interest rates. Companies like Selçuk Ecza need to be more aware of the importance of diversification of their portfolio. Rather than depending heavily on the banking sector, they need to make investments to market securities while protecting their hedge position. Past experiences about the usage of the securities market also reveal that companies that are engaging in speculator activities experienced great downfalls due to bearing more risk than they can handle. Thus, Selçuk Ecza should invest in other securities to hedge their operational activities to protect themselves from both undesirable progress of the banking sector and macroeconomic collapses.

On the other hand, we observe that general ratios of the company like EBITDA margin or Net income margin are increased effectively compared to other industries. Especially demolition of the construction industry is an important hint to see poor macroeconomic condition among Turkey since that industry constitutes the majority of the Turkish economic activity. Selçuk Ecza has clearly shown its capability to overcome the poor economic condition by raising its market share while others try to decrease to meet their obligations. Their safe position against the overall economy is the most significant source to save themselves in a crisis period. However, companies need to bear some risk to enhance their return. Even if the safe position rescues them from bankruptcy, they should carry more risk in good economic periods to attract both foreign and local investors.

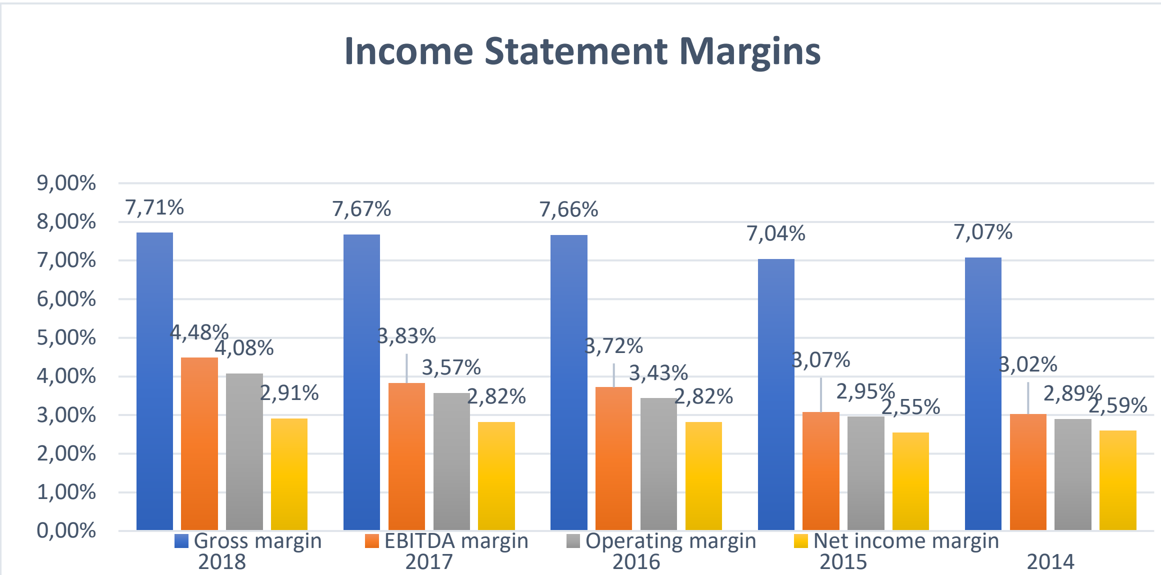

Figure 4.2.1

The next important analyze that we conduct about the profitability of the Selçuk Ecza. Their ROE, ROA, and EM are the significant sources in which we can study to see how they perform. Between 2014 and 2018, a steady increase of ROE from 10.58% to 15.84% (Figure 4.2.2) indicates that the company is successful to meet the expectations of the shareholders. Moreover, DuPont identity of the ROE is more important than the numbers itself. After further investigations, we saw that Selçuk Ecza hold its leverage ratio at a range of 2 – 2.5 times through the sample period. So, our initial finding of profitability is that the primary source of high ROE comes from the effective usage of assets. In between the sample period, Return on Assets is also raising from 4.88% to 6.13%. The company did not change the leverage status as an indicator of their safe position. The asset turnover ratio and profit margin of the company can be seen as successful compared to the overall economy and its condition. Therefore, the return to equity mostly derived from operational success. Also, as we mentioned earlier, is a pharmaceutical company (even if the company only operates as a warehouse) is an vital source to derive high ROE.

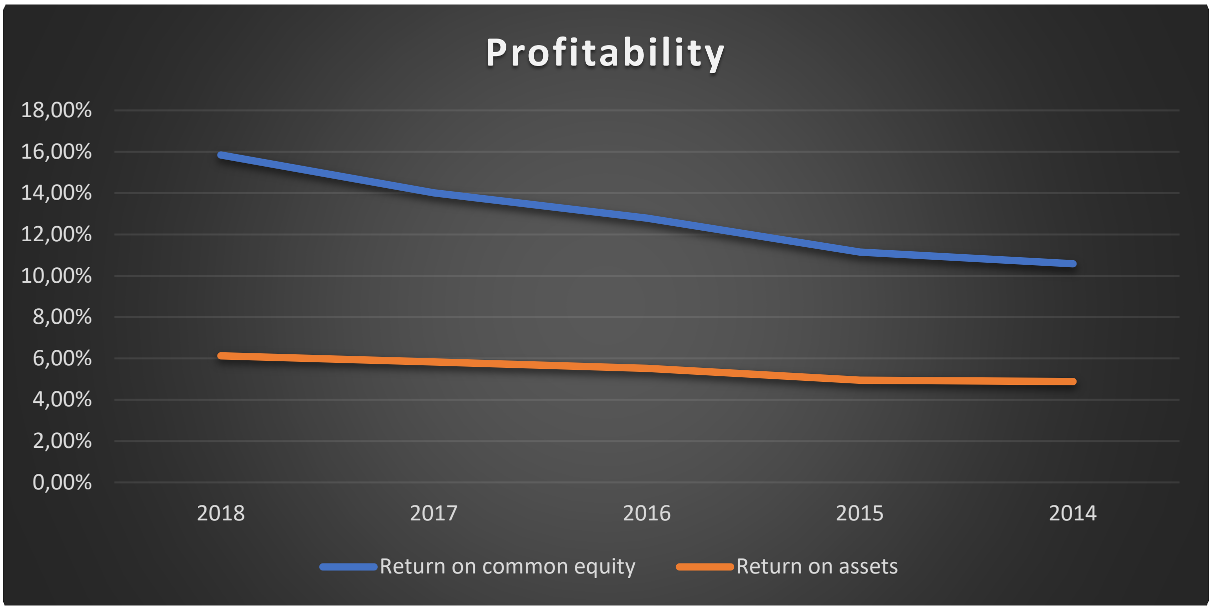

Figure4.2.2

4.3.Statement of Cash Flows

The primary purpose of the cash flow statement is to show the flow of cash. Where the cash goes and where does the cash come from is the main questions that a cash flow statement answer. Cash inflows and outflows provide insight into the liquidity and solvency, as well the company's ability to meet future needs for capital and growth. The main assumption the cash flow statement is using not accrual basis but cash basis accounting principles. Selçuk Ecza Deposu A.Ş. has a net income balance that constantly increases throughout the years, which is a sign of success. Making the right decisions through investments allows the company to increase its net income compared to previous years. It is crucial to indicate that exchange rate fluctuations do not affect the company since the company is acting as a distributor. Operating activities: cash received or left from day-to-day operations shown in operating activities. Non-Cash expenses are added to the operating income. Operating activities expected to show the current business plan and operations of the entities. The main part that affects the operating activities is the change in the net working capital account, especially in account receivables and inventory. Between 2016 and 2018, increase in changes in accounts receivable is important. This increase can be explained by the change in company policy. The company loses its receivables policy. Also, changes in liabilities are also increasing steadily between 2014 and 2018. This increase can be explained by the change in payables, which indicates the company is relying on its suppliers as the years passed. Especially between 2017 and 2018, increase in changes in liabilities is too much if it is compared with previous years. A considerable increase in changes in inventory accounts also supports the statement. Investing activities: outflow of the cash because of long-term assets such as land, buildings equipment, etc. and inflows from the sale of assets, businesses, and securities. Most entities make long term investments for operations and future growth; that is why investing activities mostly has negative cash balance. Selçuk Ecza does not incur significant changes in investment activities. The capital expenditures of the company slightly increased between 2014 and 2018. According to the company's 10-K financial reports, the company is planning to enter a new market in near future. So, the company only makes the necessary investments to support the future growth of its existing operations. Little changes in investing activities can be attributed to this cause. Financing activities: cash outflow to the investors such as interest to bondholders and shareholders such as dividends and stock buybacks and cash inflow from sales of bonds or issuance of stock equity. Most cash flows from financing activities are cash outflows since most companies only issue bonds and stocks occasionally. Selçuk Ecza's dividend payments constantly increase between 2014 and 2018, which is a good sign for both existing investors and possible investors since there is no new issuance of stocks. The main account that changes the financial activity balance is net borrowings. There are fluctuations between the years in a net borrowing account. Change in net borrowing account could be a sign of change in capital structure decisions. But since the account is fluctuating quite fast, it may draw a bad scenario for investors. Using debt in the capital structure makes Selçuk Ecza riskier, which creates a problem for rational investors. To sum up, the information provided from the cash flow statement of Selçuk Ecza shows,

- The increase in cash and cash equivalents between 2015 to 2016, namely from minus 76 million to plus 33 million respectively can be explained by changes in liabilities that come from the payables. Change in payables shows change policy about payables.
- The decrease in cash and cash equivalents between 2016 and 2017, namely from 33 million to 7 million respectively can be explained by changes in net borrowings and

changes in accounts receivable. An increase in net borrowings can be explained by the change in capital structure, which is an indicator to increase in leverage. Also, an increase in accounts receivable can be explained by changes in accounts payable in the previous year to match the duration between payables and receivables.

- The decrease in cash and cash equivalents between 2017 and 2018 namely from 7 million to minus 27 million respectively can be explained by again change in net borrowings, changes in inventory, change in liabilities and lastly change in accounts receivables. Increase in accounts receivables and payables explained by changes in company policy about their collections from its customers and their payables to its suppliers. Changes in borrowings again show the company continues to use leverage in its operations. Also, changes in inventory can be explained by precautions that the company takes to meet the demand.

5. Remarks on the Company Situation

Selçuk Ecza Deposu A.Ş. is the oldest and significant participant in its sector. Pharmaceutical product market in Turkey is reimbursed by the state, and very favorable in terms of demographic conditions of the country. Only 20% of the total population is above the 50-year-old. The growth rate of the young population is high, and the population is rapidly aging over time. These two characteristics are the most important demographic factors that accelerate growth in the pharmaceutical market. The company also has no foreign exchange rate risks and can protect itself from interest rate changes thanks to their accounts receivables which is equal to total debt and the company can offset the interest expenses on debts and accounts payable with the interest revenues from accounts receivables.

6. Valuation of the Company's Stock Price

Selçuk Ecza Deposu A.Ş. is operating in a defensive sector, has a stabilized growth in equity, revenue, and has no market risk. Currently, the company is traded at 3,90 TL per share and has 6.19 P/E and 0.98 markets to book ratio.

Recent price raise (26.4%) on medicine positively affected profit expectations in 2019. Company has 1.500 million TL worth of inventory, and with the 26.4% price hike, we are expecting a 396 million one-time gain from inventory, and 18.88% growth in net profit, in 2018 net profit was 391 million TL and 166 million TL excluding the last year's price hike. In 2019, with an 18.88% growth on 166 million TL and 396 million TL one-time revenue, we are expecting 593 million net profit. As a result of our logical and technical reasoning, we are recommending that investors should buy stocks of Selçuk Ecza Deposu A.Ş., especially in difficult times such as 2019, when economy going through contraction. Last increase in market interest rate deteriorated our 12-month P/E expectations, but our 12-month target price is 5,32.

Appendix

Balance Sheet					
(TL Million)	**2014**	**2015**	**2016**	**2017**	**2018**
Assets					
Cash and Cash Equivalents	7.47	4.58	4.77	4.21	2.98
Accounts Receivable	58.55	59.52	59.87	61.75	60.74
Inventories	21.64	22.20	21.39	19.60	22.63
Other Current Assets	1.86	2.18	2.15	2.30	2.17
Total Current Assets	89.52	88.49	88.17	87.86	88.52
PP&E	8.56	9.39	9.53	9.38	9.12
Intangible Assets (Including Goodwill)	0.94	0.84	0.73	0.63	0.50
Other Non-Current Assets	0.45	0.64	0.97	1.19	0.86
Deferred Tax Assets	0.53	0.64	0.60	0.95	1.00
Total Non-Current Assets	10.48	11.51	11.83	12.14	11.48
Total Assets	100.00	100.00	100.00	100.00	100.00
Liabilities					
Short Term Debt	1.03	2.31	0.98	0.93	1.67
Account Payable	50.43	50.83	52.96	54.03	56.39
Provisions & Other Current Liabilities	1.47	1.46	1.69	2.08	1.93
Total Current Liabilities	52.94	54.60	55.64	57.04	59.99
Long Term Debt	0.00	0.00	0.00	0.00	0.00
Provision for Employee Benefits & Other Liabilities	0.56	0.63	0.70	0.63	0.59
Deferred tax liability	0.36	0.42	0.46	0.73	0.76
Other liabilities	0.00	0.00	0.00	0.00	0.00
Total Non-Current Liabilities	0.92	1.05	1.17	1.36	1.35
Shareholder's equity & minority interest	46.14	44.34	43.20	41.60	38.67
Total Liabilities & Equity	100.00	100.00	100.00	100.00	100.00

Table 1

Cash Flow

(in thousands)

	12/31/2018	12/31/2017	12/31/2016	12/31/2015
Net Income	391,268	301,098	243,616	190,697
Operating Activities				
Depreciation	39,874	28,800	21,206	17,117
Adjustments to Net Income	-20,432	22,573	33,906	21,183
Changes in Accounts Receivables	-828,488	-639,858	-418,233	-373,888
Changes in Liabilities	922,496	510,779	406,438	284,545
Changes in Inventories	-432,213	-69,934	-86,390	-123,511
Changes in Other Operating Activities	-16,184	1,125	6,028	-26,233
Total Cash Flow from Operating Activities	56,320	154,583	206,570	-10,090
Investing Activities				
Capital Expenditures	-137,324	-111,696	-79,792	-90,286
Investments	-	-	-	-
Other Cash flows from Investing Activities	44,682	8,435	9,088	14,518
Total Cash Flows from Investing Activities	-80,373	-100,497	-84,713	-82,641
Financing Activities				
Dividends Paid	-62,100	-51,543	-42,500	-37,881
Sale Purchase of Stock	-	-	-	-
Net Borrowings	58,821	4,678	-45,760	54,078
Other Cash Flows from Financing Activities	-	-	-	-
Total Cash Flows from Financing Activities	-3,279	-46,865	-88,260	16,197
Effect of Exchange Rate Changes	-	-	-	-
Change in Cash and Cash Equivalents	-27,332	7,221	33,597	-76,535

Table 2

References

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