

Polish meat sector

Poland, Food sector

21 January 2005

2005: EU rally is over. Welcome to business as usual.

Upgrading Duda (Fair Value of PLN 127) to Hold from Reduce and Indykpol to Accumulate (FV of PLN 71) from Hold. Reiterating Hold for Sokolow (FV of PLN 5.4).

In line with our expectations, 4Q04 brought a reversal in meat prices on the Polish meat market. The Ministry of Agriculture anticipates continuation of the down-trend in 2005 and a fall to pre-accession levels. Since the commodity price decrease was deeper than the correction of processed meats prices, we expect Sokolow and Indykpol to regain in 4Q04 and beyond some of the margin deterioration from 9M04. On the other hand, we expect the EU-status of Poland to stabilise the Polish meat market and slightly decrease Duda's margins. We upgrade Duda to Hold (FV of PLN 127) from Reduce and Indykpol to Accumulate (FV of PLN 71) from Hold, and reiterate our Hold recommendation on Sokolow (FV of PLN 5.4).

The rally in meat commodities in Poland, which strongly outpaced the growth in processed meat prices and therefore negatively affected margins of meat processing companies Sokolow and Indykpol, reversed in 4Q04. Prices fell to near pre-accession levels, and given the extraordinarily good grain harvests and strong PLN, the Ministry of Agriculture expects the declines to go even deeper.

We anticipate Sokolow and Indykpol to regain some of the margin deterioration from 9M04 in 4Q04 and beyond. On the other hand, we believe that the expected continuation of the down-trend in pork prices and the EU status of Poland, which should stabilise the domestic meat market, will slightly decrease Duda's margins.

We have revised our valuation models incorporating new FX estimates and lowered risk free rate to 6.5%. Consequently, our new current fair value amounts to PLN 5.4 for Sokolow, PLN 127 for Duda and PLN 71 for Indykpol.

We have upgraded our recommendation for Duda from Reduce to Hold, as the 4.4% decline since our last report consumed the majority of the downside risk. Expecting a margins rebound in Indykpol, we have also upgraded the company's rating from Hold to Accumulate. We reiterate our Hold recommendation on Sokolow.

Polish meat sector: Valuation summary

Company	Ticker	Price	Fair value	Upside	Recommend.	P/E* (x)			
		(PLN)	(PLN)	potential		2003	2004E	2005E	2006E
Sokolow	SKW PW	5.15	5.40	4.9%	Hold	27.0	40.2	16.3	14.2
Duda**	DUD PW	131	127	-3.1%	Hold	43.3	25.1	15.5	13.5
Indykpol	IND PW	66.7	71.0	6.4%	Accumulate	18.5	18.3	14.5	11.3

* P/E adjusted by goodwill and one-offs, ** Fully diluted fair value; Source: Company data, DM BZ WBK estimates

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Investment summary

Meat commodity prices rocketed due to EU-accession – the major driver of Duda's success...

Prices of commodities, such as livestock and halves, in Poland rocketed on the verge of the EU-accession (from January to May, prices rose from 1% for turkey to 33% for pork) and continued their rise afterwards (further growth of 10% for turkey and 22% for pork from May to September), mainly due to growth in export sales of Polish companies after opening of EU borders. This exceptional price surge was the major growth driver of Duda, the primary player on the Polish pork meat market.

...while the dynamics of prices of processed goods was much lower, which deteriorated margins on Sokolow and Indykpol...

On the other hand, the dynamics of prices of processed meat such as sausage or ham wasn't so impressive (up 12% from January to May and another 12% from May to July for pork, and a negative 6% and positive 13% for turkey, respectively). We believe that the major reason for such a development was limited demand for Polish-branded processed meat in the EU countries, possibly caused by the different regional tastes and food habits. Therefore the majority of the processed meat was placed on the domestic market, where consumers didn't accept major price jumps. Consequentially, the surging raw material prices accompanied by the much lower price growth of the end-products significantly deteriorated the profitability of meat processing companies.

...further worsened by the strong PLN appreciation

Moreover, the strong Polish currency appreciation had a negative impact on exporters, i.e. Sokolow (app. 22% of export sales in 2004E) and Indykpol (app. 32% of export sales in 2004E). Duda, which also sells part of its production (app. 25% of export sales in 2004E) abroad, wasn't affected to such an extent, due to much shorter contracts and more flexible conditions of foreign trade in commodities, in our view.

4Q04 – back to business as usual

The 4Q04 brought a reversal on the meat market. The prices of all major assortments fell near the pre-accession levels. As the decrease in the commodity prices (10% for pork and 11% for turkey) was much deeper than the correction in the processed goods prices (2.4% for pork and 6.5% for turkey), we expect improvement in margins of meat processing companies Sokolow (gross margin of 16.3% in 4Q04E vs. 12.6% in 9M04) and Indykpol (gross margin of 25.9% in 4Q04E vs. 12.0% in 9M04). On the other hand, we anticipate slight deterioration in Duda's margins (net margin of 3.6% in 4Q04E vs. 4.7% in 9M04).

2005 – expected revival of meat processors

The Ministry of Agriculture and Rural Development expects the downtrend in pork prices should be sustained and poultry prices to remain near current levels in 2005. Therefore we expect Sokolow and Indykpol to regain some of the margin deterioration from 2004 in 2005 and beyond. On the other hand, we believe that the EU-status of Poland will stabilise the domestic meat market and slightly decrease the margins of Duda.

Decreased FX rates assumptions forced lower financial forecasts of Sokolow and Indykpol

We have revised our earnings forecasts for our Polish meat company universe. The major changes apply to exporters Sokolow and Indykpol. Changes in the FX rate assumptions to PLN/EUR 4.14 from 4.33 in 2005, and to 4.00 from 4.25 in 2006 and beyond were the major drivers of the reduction in our forecasts of underlying EPS by 15.1% in 2005 and 15.2% in 2006 for Sokolow, and 3.6% in 2006 for Indykpol.

Fair Value: Sokolow PLN 5.4, Duda PLN 127, Indykpol PLN 71

Our amended DCF models, based on the lower risk free rate assumption (6.5%), imply new fair values: PLN 5.4 for Sokolow, PLN 127 for Duda and PLN 71 for Indykpol.

We prefer Indykpol (Accumulate) over Duda (Hold) and Sokolow (Hold)

We have upgraded our recommendation for Duda from Reduce to Hold, as the stock's weakness since our last report consumed the majority of the downside risk. Despite a reduction in the valuation price we have upped our rating for Indykpol from Hold to Accumulate, which makes the turkey processing company our top-pick in the sector. We repeat our Hold recommendation for Sokolow.

Valuation and recommendation update

Comparable valuation

2006E P/E in line with multinational peers

The Polish meat processing companies trade at our 2005E and 2006E P/E of 15.4x and 13.0x, implying 12.9% and 3.9% premiums to multinational peers, respectively.

The cheapest company among the sector in Poland is Indykpol, both on P/E and EV/EBITDA multiples.

Fig. 1. Polish meat sector: Comparable valuation

Company	Country	Curr.	Price	P/E (x)				EV/EBITDA (x)				
				2003	2004E	2005E	2006E	2003	2004E	2005E	2006E	
Sokolow	SKW PW	Poland	PLN	5.15	27.0	40.2	16.3	14.2	8.8	8.8	6.8	6.3
Duda	DUD PW	Poland	PLN	131.00	43.3	25.1	15.5	13.5	26.2	15.5	9.8	8.8
Indykpol	IND PW	Poland	PLN	66.70	18.5	18.3	14.5	11.3	6.2	9.1	6.6	6.7
Average - Polish meat companies					29.6	27.9	15.4	13.0	13.8	11.1	7.7	7.3
Northern Foods	NFDS LN	UK	GBP	1.59	11.6	10.7	10.2	n/a	6.3	6.2	5.8	n/a
Atria	ATRAV FH	Finland	EUR	12.36	15.6	11.7	10.9	10.7	3.9	3.3	3.2	3.0
HK Ruokatalo	HKRAV FH	Finland	EUR	8.05	12.7	13.2	11.8	10.4	5.0	4.8	4.2	4.1
Axfood	AXFO SS	Sweden	SEK	219.00	18.2	17.0	15.2	n/a	7.5	7.1	6.7	6.2
Campofrio	CPF SM	Spain	EUR	11.74	22.7	19.2	15.8	15.9	7.8	7.5	6.8	6.9
Fleury Michon	FLE FP	France	EUR	38.00	15.3	13.9	13.1	11.3	4.5	4.0	3.8	3.6
LDC	LOUP FP	France	EUR	60.00	16.2	14.9	14.2	12.8	4.6	4.6	4.2	3.8
Average - European companies					16.0	14.4	13.0	12.2	5.7	5.4	5.0	4.6
Hormel Foods	HRL US	USA	USD	30.44	23.2	19.5	17.4	16.0	11.2	9.8	9.1	8.2
Pilgrims Pride Corp.	PPC US	USA	USD	35.02	n/m	14.2	12.5	11.9	33.0	6.8	6.0	6.0
Smithfield Foods	SFD US	USA	USD	29.45	n/m	19.6	13.6	11.6	17.7	9.9	8.0	7.2
Tyson Foods	TSN US	USA	USD	17.84	22.3	15.8	15.5	12.1	7.9	6.9	7.3	n/a
Average - American companies					22.8	17.3	14.8	12.9	17.5	8.4	7.6	7.1
Average - all foreign companies					17.5	15.4	13.7	12.5	10.0	6.5	5.9	5.4

Source: Company data, IBES, Bloomberg, DM BZ WBK estimates

DCF

Risk free rate assumption decreased to 6.5% from 7.0%

The recent strong drop in the Polish government bond rates forced us to decrease the risk free rate applied in our DCF models from 7.0% to 6.5%. Given the unchanged equity risk premium and unlevered beta, our WACC estimates fell to 9.5% in Sokolow (down from 10.0%) and Duda (down from 9.9%) and to 9.3% in Indykpol (from 9.5%). Our other key DCF assumptions are presented in the figure below.

Fig. 2. Polish meat sector: Key DCF assumptions

	Sokolow	Duda	Indykpol
Revenues CAGR 2004-06	15.3%	47.3%	6.8%
Revenues CAGR 2007-14	8.2%	5.9%	5.5%
Avg. EBIT margin 2005-2014	3.5%	5.9%	4.4%
Reinvestment rate 2014	22.6%	9.3%	18.6%
Average ROIC 2005-14	12.2%	20.5%	13.8%
Terminal growth rate	2.8%	1.9%	2.6%
Unlevered beta (x)	0.71	0.71	0.71
Levered beta (x)	0.95	0.96	1.60
Cost of Equity	10.8%	10.8%	13.7%
WACC	9.5%	9.5%	9.3%

Source: www.damodaran.com, DM BZ WBK estimates

Fair values: Sokolow PLN 5.4, Duda PLN 127, Indykpol PLN 71

Applying our revised earnings forecasts and new risk free rate, we have updated our DCF models. Our new fair value estimate for Indykpol of PLN 71 offers 6.4% upside from current market price. We estimate the current fair value of Sokolow at PLN 5.4, 4.9% above market price, while our fair value for Duda of PLN 127 is 3.1% below market price.

Change in recommendations

Sokolow: Hold reiterated

We reiterate our Hold rating on Sokolow. However, after the tender called by Saturn Nordic Holding, the free float of Sokolow dropped by 20.2pp to 27.2%, and it is very likely, in our view, that the strategic investor will cross the 75% threshold. Therefore, we believe that the company may leave some investors' screens, and therefore possibly trade below our DCF-implied fair value.

Duda upgraded to Hold

We upgrade Duda from Reduce to Hold, mainly on valuation grounds, as the 4.4% decrease in the company's shares price since we published the Reduce recommendation has consumed the majority of downside to our fair value.

Indykpol upgraded to Accumulate

Our recommendation on Indykpol was upgraded from Hold to Accumulate. After the recent weakness in the company's stock price caused by weak 3Q04 results, reduction of the FY2004 management forecasts and very strong PLN, we believe investment in Indykpol's shares offers an attractive upside. However, we have to point out that the low liquidity of the company's shares may cause a permanent divergence between market price and fundamental value.

Fig. 3. Polish meat sector: Changes in recommendations
In PLN per share, unless otherwise stated

Company	Fair	Current	Upside	Recommendation		Target
	value	price	to Fair Value	New	Old	price*
Sokolow	5.40	5.15	4.9%	Hold	Hold	6.0
Duda	127	131	-3.1%	Hold	Reduce	139
Indykpol	71.0	66.7	6.4%	Accumulate	Hold	80

* at the end of 2005, Source: Bloomberg, DM BZ WBK estimates

4Q04 results preview

Sokolow

4Q04E: revenues growth of 35.8% y/y...

We estimate Sokolow revenues in 4Q04 grew 35.8% y/y to PLN 358.3m. The improvement of the price differential between raw materials and the company's products should be the main driver of gross margin growth to 16.3% from 12.6% in 9M04, in our view. As a result, we expect a 4Q04 gross profit of PLN 58.5m, 47.1% higher than in the respective period in 2003.

...EBIT growth of 9.9% y/y...

However, the estimated 48.6% growth y/y in the SG&A expenditures to PLN 54.7m should have a negative impact on the EBIT. We estimate the operating profit of Sokolow in 4Q04 should reach PLN 9.5m (up 9.9% y/y).

...and 28.2% y/y decline in earnings

Moreover, the lower estimated influence of the tax-asset should have affected the net profit margin. We estimate Sokolow's earnings will fall at PLN 8.2m in 4Q04, 28.2% below the respective period result in 2003.

Fig. 4. Sokolow: 4Q04 financial results preview
PLN in millions, unless otherwise stated

	4Q04E	4Q03	% chng	FY2004E	FY2003	% chng
Revenues	358.3	263.7	35.8%	1,360.1	1,037.1	31.1%
Gross profit	58.5	39.8	47.1%	184.7	146.4	26.2%
EBITDA	18.1	18.7	-3.3%	68.1	68.0	0.2%
EBIT	9.5	8.7	9.9%	28.4	27.2	4.5%
Net profit	8.2	11.5	-28.2%	41.7	19.1	118.0%
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Gross margin	16.3%	15.1%	1.3pp	13.6%	14.1%	-0.5pp
EBITDA margin	5.0%	7.1%	-2.0pp	5.0%	6.6%	-1.5pp
EBIT margin	2.7%	3.3%	-0.6pp	2.1%	2.6%	-0.5pp
Net margin	2.3%	4.3%	-2.0pp	3.1%	1.8%	1.2pp

Source: Company data, DM BZ WBK research

Duda

4Q04E: revenues growth of 77.2% y/y...

According to our estimates, the 4Q04 consolidated revenues of Duda jumped 77.2% y/y to PLN 173.2m, due to the consolidation of newly acquired companies, Makton and Eurosmak (estimated contribution of PLN 46.7m) and inspiring growth of other companies from the Duda group (up 29.4% y/y to PLN 126.5m).

...EBIT growth of 50.3% y/y...

The consolidation of the retail companies has negatively impacted Duda's margins, in our view. We estimate the EBIT margin shrank by 1.1pp. As a result, we expect the 4Q04 operating profit of Duda to grow by 50.3% to PLN 10.7m.

...earnings growth of 71.9% y/y

We forecast the 4Q04 goodwill-adjusted net profit of Duda to come in at PLN 6.9m, 71.9% higher than in the respective period in 2003.

Fig. 5. Duda: 4Q04 financial results preview*PLN in millions, unless otherwise stated*

	4Q04E	4Q03	% chng	FY2004E	FY2003	% chng
Revenues	173.2	97.7	77.2%	568.9	327.8	73.6%
Gross profit	15.9	9.2	73.7%	50.9	29.5	72.5%
EBITDA	19.4	12.0	61.4%	44.1	26.1	69.2%
EBIT	10.7	7.2	50.3%	35.5	21.2	67.2%
Net profit	6.2	3.9	58.9%	24.8	12.9	91.9%
Goodwill adjusted net profit	6.9	4.0	71.9%	25.9	13.1	98.7%
Gross margin	9.2%	9.4%	-0.2pp	8.9%	9.0%	-0.1pp
EBITDA margin	11.2%	12.3%	-1.1pp	7.8%	8.0%	-0.2pp
EBIT margin	6.2%	7.3%	-1.1pp	6.2%	6.5%	-0.2pp
Net margin	3.6%	4.0%	-0.4pp	4.4%	3.9%	0.4pp

Source: Company data, DM BZ WBK research

Indykpol

Our 4Q04E estimates in line with management

Our estimates of Indykpol's financial results are broadly in line with the management forecasts implied by FY2004 management estimates.

Fig. 6. Indykpol: Management 4Q04 financial forecasts implied by the revised FY2004E management estimates*PLN in millions, unless otherwise stated*

	4Q04E			FY2004E		
	DM BZ WBK	Management	% diff.	DM BZ WBK	Management	% diff.
Revenues	152.5	144.9	5.3%	609.7	602.0	1.3%
EBIT	4.5	4.6	-1.6%	17.9	18.0	-0.4%
Net profit	2.4	2.5	-4.3%	11.4	11.5	-0.9%
EBIT margin	2.9%	3.1%	-0.2pp	2.9%	3.0%	-0.1pp
Net profit margin	1.6%	1.7%	-0.2pp	1.9%	1.9%	-0.0pp

Source: Company data, DM BZ WBK research

4Q04E: revenues decline of 7.8% y/y...

We expect that the strong Polish currency and lower goose meat sales to Germany will negatively affect Indykpol's sales in 4Q04 (down 7.8% y/y to PLN 152.5m).

However, due to improving pricing conditions (raw material prices dropped 11.0% in December vs. a peak recorded in September, while the prices of the major products of Indykpol slipped 6.5% in the respective period), seasonally strong year-end and the first material effects of a new marketing policy, we expect the gross margin to improve from a weak 12.0% in 9M04 to 25.9% in 4Q04. As a result, we expect Indykpol's 4Q04 gross profit to amount to PLN 39.4m, up 2.4% y/y.

...EBIT drop of 73.3% y/y...

We believe the change in marketing policy caused the SG&A expenditure growth, which we estimate at 21.9% y/y to PLN 27.1m. Therefore, despite the expected improvement in the gross margin, the estimated EBIT margin dropped 7.2pp y/y to 2.9% in 4Q04. We estimate an operating profit of PLN 4.5m in 4Q04, down 73.3% y/y.

...earnings downturn of 68.5% y/y

All in all, we expect Indykpol to report 4Q04 net profit of PLN 2.4m, 68.5% below the respective period result in 2003.

Fig. 7. Indykpol: 4Q04 financial results preview*PLN in millions, unless otherwise stated*

	4Q04E	4Q03	% chng	FY2004E	FY2003	% chng
Revenues	152.5	165.5	-7.8%	609.7	560.1	8.8%
Gross profit	39.4	38.5	2.4%	94.4	96.7	-2.4%
EBITDA	8.3	21.6	-61.7%	33.1	48.1	-31.1%
EBIT	4.5	16.8	-73.3%	17.9	32.9	-45.6%
Net profit	2.4	7.6	-68.5%	11.4	11.2	1.3%
Gross margin	25.9%	23.3%	2.6pp	15.5%	17.3%	-1.8pp
EBITDA margin	5.4%	13.1%	-7.6pp	5.4%	8.6%	-3.2pp
EBIT margin	2.9%	10.1%	-7.2pp	2.9%	5.9%	-2.9pp
Net margin	1.6%	4.6%	-3.0pp	1.9%	2.0%	-0.1pp

Source: Company data, DM BZ WBK research

Forecasts revision

Sokolow

FX assumptions cuts...

Due to changes in the 2004-05 FX rate forecasts (from 4.55 PLN/EUR to 4.53 PLN/EUR in 2004, from 4.33 PLN/EUR to 4.14 PLN/EUR in 2005E and from 4.25 PLN/EUR to 4.00 PLN/EUR beyond 2005) and lower than expected spread between prices of raw materials and final products, we have reduced our financial forecasts for Sokolow.

...result in minor declines in revenues forecasts...

Our 2004E revenue forecasts were trimmed by 0.3% to PLN 1360.1m. We have also cut the 2005-06 sales forecasts by 1.3% and 1.8% to PLN 1,468.2m and 1,587.9m, respectively.

...but EBIT estimates were slashed by 12.5%-18.6%...

Since almost one fourth of Sokolow's products are exported, the revision of FX rate assumptions has also hurt expected profit margins. Consequentially, we decreased our EBIT estimates by 18.6% to 28.4m for 2004, by 12.5% in PLN 48.2m in 2005 and by 13.0% to PLN 54.1m in 2006.

...and recurring profit 15.1%-26.0%

Our new recurring net profit forecasts for Sokolow amount to PLN 12.8m in 2004 (down 26.0%), PLN 31.6m (down 15.1%) in 2005 and PLN 36.4m (down 15.2%) in 2006.

Fig. 8. Sokolow: Financial forecasts revision
 PLN in millions, unless otherwise stated

	2004E			2005E			2006E		
	New	Old	% chng	New	Old	% chng	New	Old	% chng
Revenues	1,360.1	1,363.7	-0.3%	1,468.2	1,486.8	-1.3%	1,587.9	1,616.6	-1.8%
Gross profit	184.7	191.6	-3.6%	216.9	225.9	-4.0%	236.5	247.8	-4.6%
EBITDA	68.1	73.6	-7.4%	88.5	94.3	-6.1%	95.7	102.5	-6.6%
EBIT	28.4	34.9	-18.6%	48.2	55.1	-12.5%	54.1	62.1	-13.0%
Net profit	41.7	35.9	16.2%	31.6	37.2	-15.1%	36.4	42.9	-15.2%
Adjusted net profit*	12.8	17.4	-26.0%	31.6	37.2	-15.1%	36.4	42.9	-15.2%
Gross margin	13.6%	14.0%	-0.5pp	14.8%	15.2%	-0.4pp	14.9%	15.3%	-0.4pp
EBITDA margin	5.0%	5.4%	-0.4pp	6.0%	6.3%	-0.3pp	6.0%	6.3%	-0.3pp
EBIT margin	2.1%	2.6%	-0.5pp	3.3%	3.7%	-0.4pp	3.4%	3.8%	-0.4pp
Net margin	3.1%	2.6%	0.4pp	2.2%	2.5%	-0.4pp	2.3%	2.7%	-0.4pp

* Net profit adjusted by the on-off financial gains on treasury shares disposal, Source: Company data, DM BZ WBK research

Indykpol

FX assumptions cuts and delays in real estate disposal...

Due to changes in the 2004-05 FX rate forecasts and further delays in the sale of real estate in Olsztyn to Makro C&C, we have reduced our financial forecasts for Indykpol.

We have slightly (by 0.1%) decreased our FY2004 revenue forecasts for Indykpol to PLN 609.7m. As the impact of changes in FX assumptions on the 2005-06 period is more material, we have cut 2005E sales by 1.4% to PLN 642.7m, and 2006E by 1.9% to PLN 682.9m.

We have decreased the 2004 EBIT estimate by 24.5% to PLN 17.9m and, at the same time, increased the 2005 forecasts by 10.8% to PLN 29.7m, mainly due to the delay in the sale of the real estate from 2004 to 2005, which, according to the company, would contribute app. USD 1m to the operating profit. The 2006 operating profit estimate was cut mainly due to FX rate assumption changes.

...result in 2004E earnings estimates decline of 13% and 22% growth in 2005E

Consequentially, we have updated our earnings forecasts for Indykpol: 2004E to PLN 11.4m (down 12.9%), 2005E to PLN 17.5m (up 22.2%) and 2006E to PLN 16.1m (down 15.3%).

Fig. 9: Indykpol: Financial forecasts revision
PLN in millions, unless otherwise stated

	2004E			2005E			2006E		
	New	Old	% chng	New	Old	% chng	New	Old	% chng
Revenues	609.7	610.5	-0.1%	642.7	651.8	-1.4%	682.9	695.9	-1.9%
Gross profit	94.4	96.3	-2.0%	104.6	106.0	-1.3%	109.3	115.1	-5.0%
EBITDA	33.1	36.4	-9.1%	45.2	41.3	9.5%	41.9	46.1	-9.1%
EBIT	17.9	23.8	-24.5%	29.7	26.8	10.8%	26.9	31.1	-13.5%
Net profit	11.4	13.1	-12.9%	17.5	14.3	22.2%	16.1	19.1	-15.3%
Gross margin	15.5%	15.8%	-0.3pp	16.3%	16.3%	0.0pp	16.0%	16.5%	-0.5pp
EBITDA margin	5.4%	6.0%	-0.5pp	7.0%	6.3%	0.7pp	6.1%	6.6%	-0.5pp
EBIT margin	2.9%	3.9%	-1.0pp	4.6%	4.1%	0.5pp	3.9%	4.5%	-0.5pp
Net margin	1.9%	2.1%	-0.3pp	2.7%	2.2%	0.5pp	2.4%	2.7%	-0.4pp

Source: Company data, DM BZ WBK research

Appendix: Polish meat market

Pork

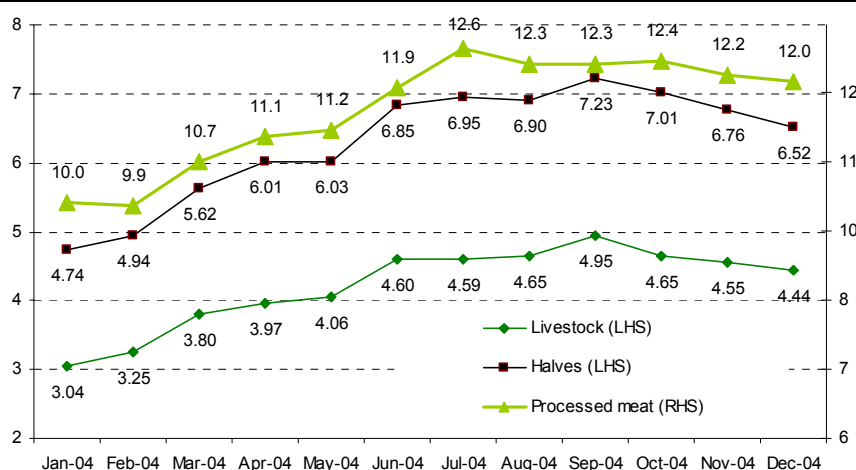
The growth-trend in livestock prices outpacing processed goods prices in 9M04...

According to the Ministry of Agriculture and Rural Development, similar to the previous years, the cyclical peak of pork prices fell in September, when the average pork livestock price reached PLN 4.95/kg (62.8% growth vs. January 2004). Pork halves prices followed the growth-trend of livestock and reached their maximum at PLN 7.23/kg (52.6% growth vs. January 2004) in September. On the other hand, the maximum prices of processed pork meat were recorded in July (PLN 12.59/kg, up 26.0% vs. January 2004).

...inverted in 4Q04

The 4Q04 brought an expected reversal of the growth-trend on the Polish pork market. Livestock prices fell 10.4% to PLN 4.44/kg in December. A slightly lower decline was recorded in pork halves, which declined 9.9% to PLN 6.52/kg. Further declines in processed meat products brought their average price 2.2% below the peak.

Fig. 10. Poland: Prices of pork livestock, halves and processed meat
In PLN/kg



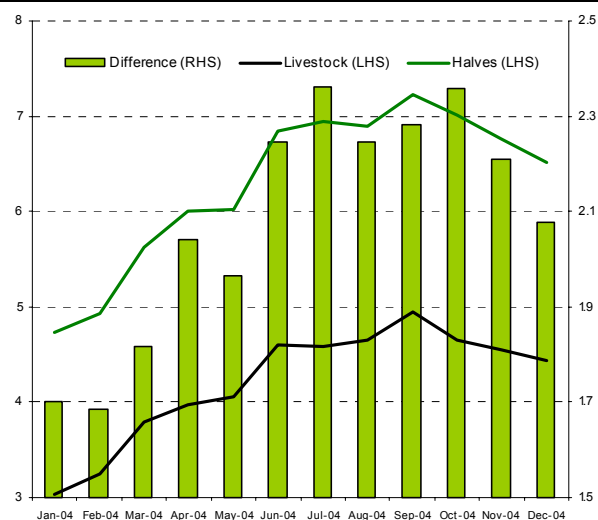
Source: Ministry of Agriculture and Rural Development (Ministry of Agriculture), DM BZ WBK research

Slaughterhouses

Flat slaughterhouses margins

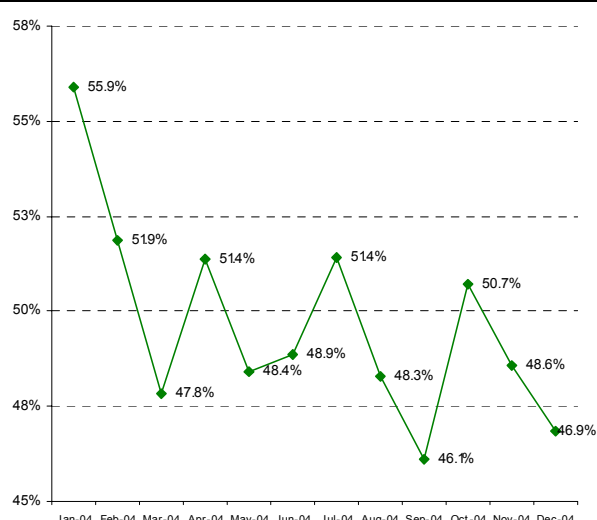
The average price differential between pork livestock and halves, which is the major driver of margins recorded by the slaughterhouses, dropped to PLN 2.22/kg in 4Q04 from PLN 2.30/kg in 3Q04. However, due to the lower base effect, the average percentage margin remained virtually unchanged.

Fig. 11. Poland: Prices of pork livestock and halves
In PLN/kg



Source: Ministry of Agriculture, DM BZ WBK research

Fig. 12. Poland: Margin on production of pork halves
In %



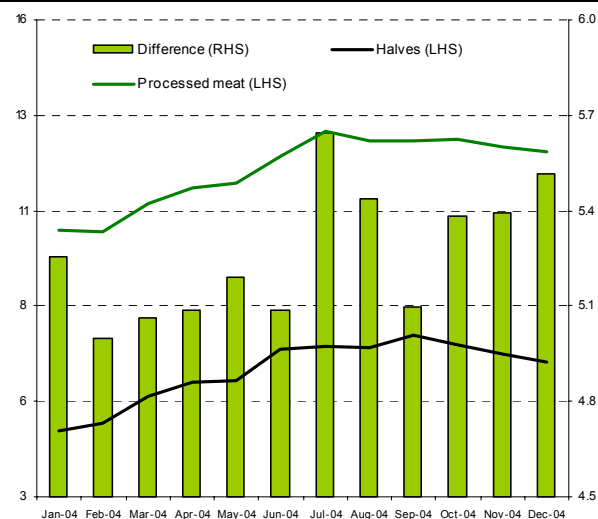
Source: Ministry of Agriculture, DM BZ WBK research

Meat processing companies

Meat processing companies' margin grew by 3.6pp in 4Q04 q/q.

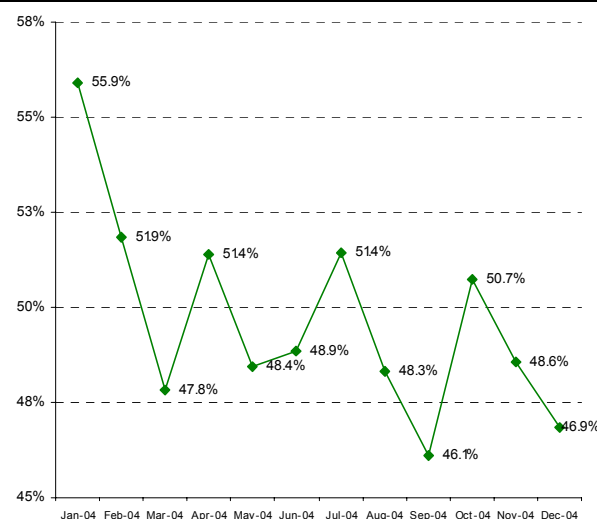
The 4Q04 brought a moderate increase of the price differential between pork halves and processed meat prices, which, accompanied by the drop in halves prices, caused the average margin on meat processing to grow 3.6pp q/q to 80.4%.

Fig. 13. Poland: Prices of pork halves and processed meat
In PLN/kg



Source: Ministry of Agriculture, DM BZ WBK research

Fig. 14. Poland: Margin on processing of pork
In %



Source: Ministry of Agriculture, DM BZ WBK research

2005 forecasts

The prices should drop to pre-accession level in 2H05:...

Despite the recent declines in the prices of pork halves, they still remained 1.1% above the average EU level. Therefore, given the exceptionally good grain harvests in 2004, the Ministry of Agriculture and Rural Development and Agricultural Market Agency expect the downtrend in pork prices should be sustained.

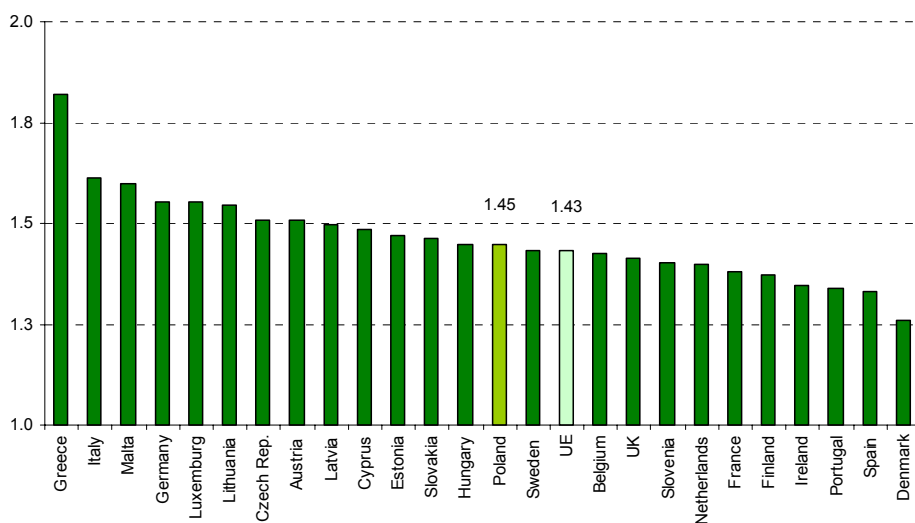
...livestock down by app. 10%...

According to the authorities, pork livestock should trade in the PLN 4.3-4.6/kg band, and drop to app. PLN 4.0/kg in 2H05, a level last recorded before the EU accession.

...halves down by app. 8%...

We expect pork halves prices to follow the downtrend on the livestock market, and drop to app. PLN 6.4-6.8 in 1H05 and app. PLN 6.0/kg in 2H05.

Fig. 15. European Union: Pork halves prices in European Union (XII 2004)
In PLN/kg



Source: Ministry of Agriculture, DM BZ WBK research

...and processed meat down by only app. 2%

We believe that processed meat prices should also fall to the pre-EU level in 2H05, which means only an app. 2% decline vs. current levels. Given the much higher expected declines in the raw material prices, we anticipate improvement in the profitability of the meat processing companies, which strongly deteriorated after the accession.

Turkey

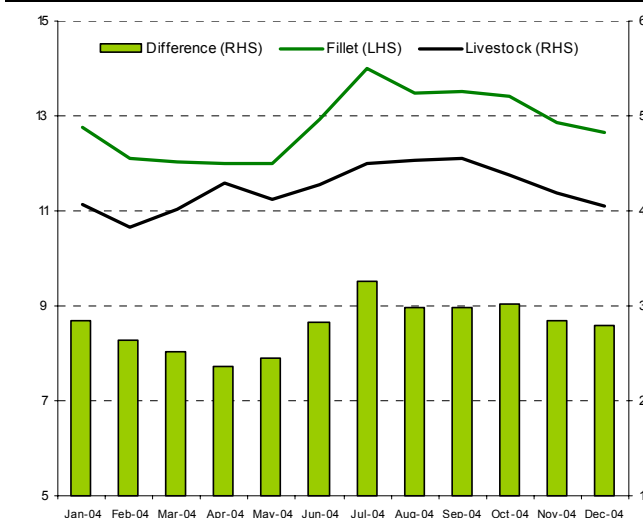
Turkey market followed the pork market in 2004

The Polish turkey market followed the pork market in 2004. The prices of turkey livestock peaked at PLN 4.55/kg in September, 11.8% above the level recorded in January. On the other hand, the dynamics of the fillet prices was app. two times lower (6.0% to PLN 13.53/kg).

The following months brought a reversal of the growth-trend on the turkey market. The prices dropped even below the January 2004 level. In December the livestock price reached PLN 4.05/kg (11.0% below September and 0.5% below January), while fillet prices fell to PLN 12.65/kg (6.0% below September and 0.9% below January).

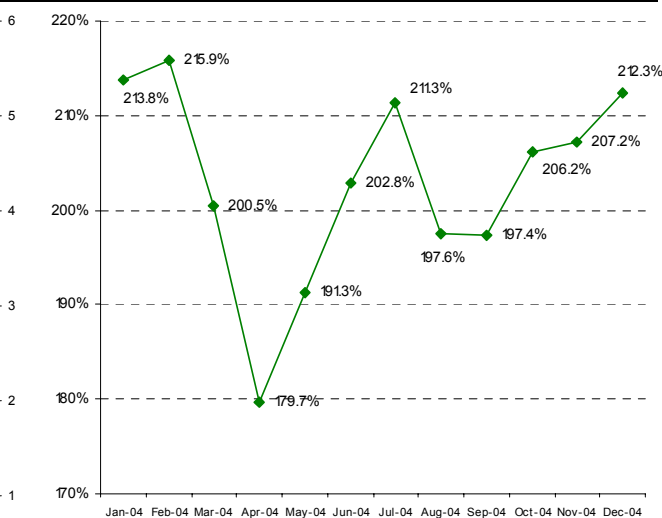
Due to a deeper drop in the raw material prices than the ones recorded in the processed meat, the profitability of turkey processing companies should have improved. We estimate that the average margin arising from the difference between the turkey livestock and fillet grew q/q 6.5pp to 208.6% in 4Q04.

Fig. 16. Poland: Prices of turkey livestock and halves
In PLN/kg



Source: Ministry of Agriculture, DM BZ WBK research

Fig. 17. Poland: Poland: Margin on production of turkey halves
In %



Source: Ministry of Agriculture, DM BZ WBK research

2005 forecasts

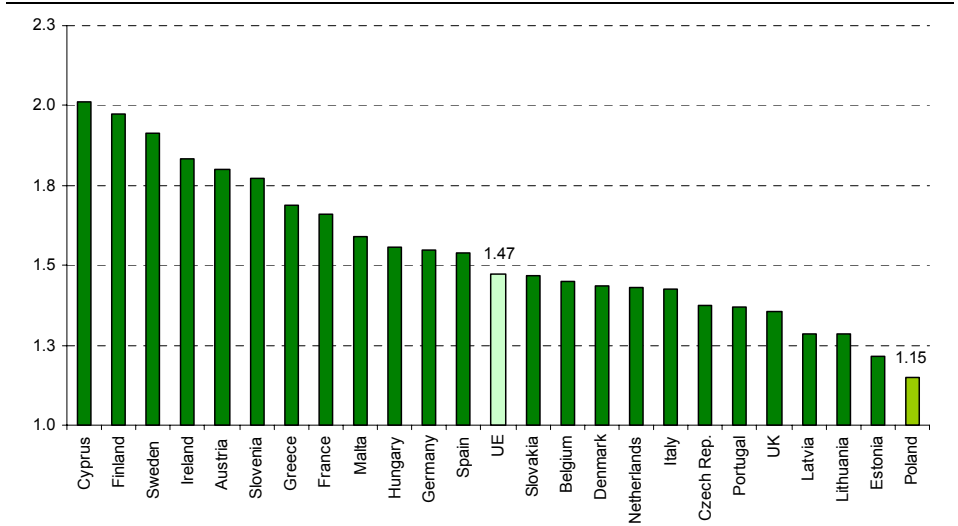
Polish poultry – the cheapest in the EU...

Poultry prices in Poland have returned to the pre-accession levels, and therefore are far below the EU average. Moreover, Polish poultry is the cheapest in comparison to all EU-25 countries. However, the reconstruction of the production base in major European poultry producers after last year's bird-disease and exceptionally good grain harvests in 2004 should prevent the Polish poultry prices from any major rebounds.

...which is expected to continue

The Ministry of Agriculture and Rural Development and Agricultural Market Agency expect the poultry prices in Poland to remain at current levels in 2005, or even continue recent declines, which we view as positive for poultry processing companies.

Fig. 18. European Union: Poultry halves prices in European Union (XI 2004)
In PLN/kg



Source: Ministry of Agriculture, DM BZ WBK research

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DCF, EVA, DDM valuation – DCF method is based on the expected future discounted monetary flows, its strengths include taking into account the future changes to monetary flows and to the cost of money in time, its weaknesses are a huge number of parameters and a sensitivity to their fluctuations.
Comparable valuation method – based on comparing market indicators of a researched company with the indicators of other comparable entities. The advantage of this method is a small number of parameters estimated by a researcher and incorporating market data. The disadvantages include uncertainty concerning the proper selection of comparable entities and the effectiveness of their market valuation.

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