Company Report

Duda

Poland, Food & Beverages

Buy

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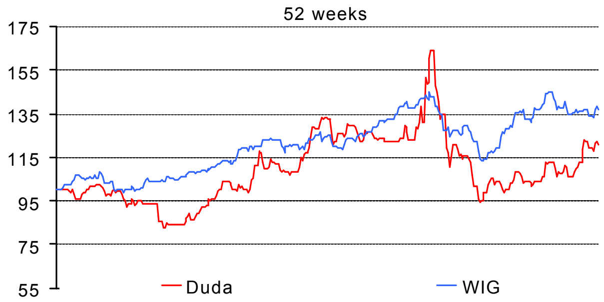
PLN mn	2005	2006e	2007e	2008e
Net sales	870.0	1,040.7	1,218.7	1,319.4
EBITDA	53.7	73.3	84.0	98.9
EBIT	38.7	54.7	64.4	75.2
Net profit	27.1	44.3	45.3	53.8
EPS (PLN)	0.56	0.91	0.93	1.09
CEPS (PLN)	0.87	1.31	1.33	1.57
BVPS (PLN)	4.29	5.10	5.99	6.12
Div/share (PLN)	0.00	0.00	0.00	0.92
EV/EBITDA (x)	14.2	10.9	9.7	8.3
P/E (x)	22.9	14.1	13.9	11.8
P/CE (x)	14.9	9.8	9.7	8.2
Dividend yield	0.0%	0.0%	0.0%	7.2%



Performance	12M	6M	3M	1M
in PLN	20.7%	-9.2%	4.5%	7.1%
in EUR	20.6%	-12.1%	4.4%	6.7%

Share price (PLN)	12.9	Reuters	DUDA.WA	Free float	65.1%
Number of shares (mn)	48.6	Bloomberg	DUD PW	Shareholders	Duda family (34.89%)
Market capitalization (PLN mn / EUR mn)	624.5 / 158.2	Div. ex-date	-		
Enterprise value (PLN mn /EUR mn)	799.2 / 202.4	**Target price**	**16.0**	Homepage:	www.zmduda.pl

Growing in all directions

- **Duda is a leading, integrated producer and distributor of pork meat. Its rapid growth stems from the vertical and horizontal consolidation of the meat market in Poland, combined with planned expansion in Ukraine. The company's strategy and recent results have confirmed that Duda is a solid growth stock. We therefore maintain our Buy recommendation.**

- **The firm's production business will be bolstered by brisk development of its Ukrainian subsidiary, exports to new markets and Duda's ambitious plan to double its number of slaughters via acquisition. Furthermore, organic growth should stand at around 10%. The main risk is the volatility on the livestock market and resulting swings in margins.**

- **Regarding its distribution business, Duda intends to cover all of Poland within two years by increasing its number of distribution centers from six to 15. This will be achieved by greenfield investments and takeovers. However, operating margins will never cross 3% in this sector. Therefore, the company must derive its competitive advantage from high volumes and size, which confer scale effects and bargaining power.**

- **Duda intends to secure its feedstock and is investing heavily in the development of pig farms. Currently, own farms constitute 10% of supply, but the company has the intention to boost this to 40-50% in two years. This step would immunize the company from changes on the livestock market and improve its quality and efficiency.**

- **The company will also benefit from smaller projects, such as entering the very profitable niche of game meat and the development of its beef arm. Moreover, Duda's cash flow receives considerable support from EU land and investment subsidies.**

- **We reiterate our Buy recommendation with a DCF-derived target price of PLN 16.0, which translates into 25% upside.**

Investment story

Three crucial segments

Duda's envisaged improvement in revenue and margins should come as a result of combined growth in three segments of the pig meat market and related synergies (production, distribution and pig farming). The company has given up its processing segment so as not to compete with the clients of its production arm, who are frequently also suppliers of Duda's distribution arm. Vertical integration is important, and each sector supplements and supports the others. What is more, the growth is fueled by the horizontal consolidation of the meat market. Profitability is helped by the scale of operations.

Ambitious goals in production

Duda commands a 5-6% market share in pig meat production, which translated into 375,000 slaughters in 1H06 (up 20% y/y). We expect that the company can grow organically by 10% per year, driven partly by higher demand, which is a result of rising domestic consumption and increasing exports; winning greater market share would also help. However, aside from the assumed development of production lines, the current plant has capacity reserves of 20%. Therefore, to reach its long-term aim of an 8-10% market share, Duda is eyeing a significant acquisition of another slaughterhouse. In our view, this move would have a positive impact on the company's top and bottom lines and would significantly strengthen its position on the meat market, although we believe that financing for such a project would not be possible with debt only. This transaction is not a near-term story, but it is quite likely to happen in the long run.

Far East a remedy for Russian ban

Exports made up 15.3% of total revenue in 2005. In the first half of 2006, exports increased to over 20%. The mid-term target is 25%. Duda is seeking export opportunities around the world to push sales up and find demand for different pork parts. This year, Ukraine and Russia banned imports of Polish meat, which resulted in a temporary price slump and stockpiling of less sought after parts (heads, fats). On the other hand, the large markets of South Korea and Japan have given a green-light to meat from Poland. Duda already exports approximately USD 6mn p.a. to South Korea and aims to double this. Entering the Japanese market looks to be stalled somewhat, but still offers considerable potential. Duda is also considering increasing sales to Western and Southern Europe, and to launch sales to Africa and China. In our opinion, no new single market would provide an incredible lift. However, these markets combined would allow for higher volumes and fattened margins, due to the higher share of pork parts compared to half-carcasses.

Ukrainian boost

Duda intends to mirror its meat concern structure in Ukraine. The company has already purchased a small abattoir and is very close to taking over a large pig farm. To start, the company plans to build a strong raw material base and trade in livestock on the market, then develop its slaughterhouse and finally expand in distribution. We estimate that, in a conservative scenario, Duda's Ukrainian subsidiary can generate PLN 15-20mn in 2007, and surge to almost PLN 70mn in 2009. The operating profitability should hover around 30%. We assume no large acquisitions (except for pig farms) and steady organic growth in other segments.

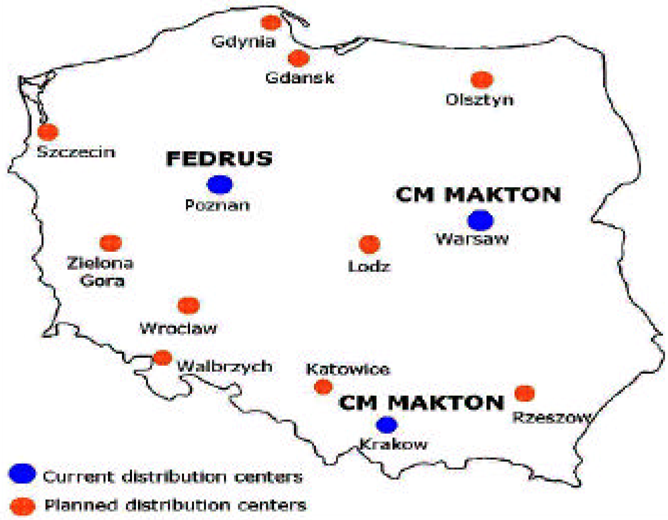
Beef and game meat a bonus

Duda is also involved in two other sectors of the meat market – a small but very profitable niche in game meat and beef slaughter. The first generates over PLN 30mn p.a. in sales, with very nice margins. The latter is now consolidated in one plant. Duda plans to focus more on its development to increase sales to PLN 60mn in two years from PLN 30mn.

Coverage is key

Duda has six distribution centers, although its coverage is far from nationwide. Entering new regions of Poland is a key to growth of revenues and obtaining appropriate scale.

Map - Distribution



Source: Duda

The goal is to have 8-10 centers by the end of 2007 and 15 by the end of 2008. Duda will acquire or build these centers from scratch. Presently, the company is in talks with an owner of two centers in northern Poland, although the negotiations are delayed. We expect that if the negotiations do not bear fruit by the end of 3Q06, the company will start a greenfield investment in that region. The meat distribution market is very fragmented. Duda has a 2-3% share, which puts it in the top three. Increasing size and volumes and offering full nationwide coverage gives leverage in negotiations with suppliers and clients and binds them more firmly to Duda. Most of the largest meat processors in Poland are selling via Duda's distribution centers, and Duda makes the most of it by urging them to purchase half-carcasses from its slaughterhouse.

Securing the rear

The risky part of the production business stems from the volatility of livestock prices, swings in the margin on slaughter and changes in the quality and output of meat. In order to protect itself from all of the above-mentioned factors, Duda is developing its own pig farming operation. Currently, 10% of its livestock comes from own farms. The mid-term target is 40-50%. In the last quarter, the company purchased the large "Rudniki" pig farm, with annual output of 130,000 pigs. This farm needs modernization and will start full operations as of 2007. Further acquisitions and development of already owned farms will allow the company to accomplish its goals. The outlays on these farms could amount to PLN 10mn. In order to comply with Polish agri regulations on pig farming, Duda has to have vast tracts of land. The company uses this land to receive EU subsidies and grow crops. Recently, it increased the share of rapeseed being grown, in light of the strong demand stemming from the biofuel boom.

Slight changes in group structure

Duda's group has changed slightly since our last report. The company sold its horse meat arm, as it was permanently in the red. It also disposed of one small company in the agri sector that did not run any operations other than to hold some land earmarked for pig farms. However, this land has not received approval to develop such a business, which triggered the company's decision. Duda also purchased Hunter-Wild, the largest producer of game meat in Poland (the sales of which are chiefly exported) and increased its stake in a beef producer from 51% to 100%.

Group structure

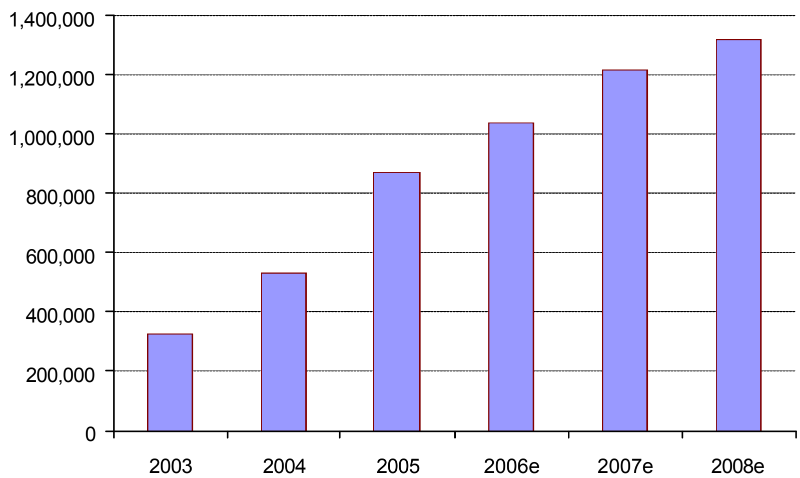
Supply, breeding and husbandry		Slaughtering, meat cutting and processing		Distribution	
		PKM DUDA – capital leader			
Pleszew	64%	Hunter Wild	100%	Makton	100%
Agroprof	100%	Euro-Duda	51%	Eurosmak	100%
Rolpol	100%	Polska Wolowina	51%	NetBrokers	56%
Agrohop	88%	Borys (Ukraine)	95%	Fedrus	100%
Bioenergia	100%			Hunter Wild GmbH	100%
Wizental	100%				
Agro-Duda	100%				

Source: Duda

The first half of 2006 was mixed for the company. Revenue jumped to a robust PLN 496.2mn (up 25%), on the back of high demand and the rising number of slaughters, as well as the consolidation of meat distributor Fedrus, which was acquired in 2H05. However, the most important profit on sales figure gained only 12.3% y/y (to PLN 14.7mn). This was a consequence of the very low margins in 1Q06, although they were made up for somewhat in 2Q06. The net profit margin in 1H06 was boosted by significant one-off items and came in at healthy 4.8% (compared to 4.3% in 1H05).

We expect Duda's top line to grow by 19.6% (to PLN 1.04bn) in 2006, driven by 20% growth in slaughters and the addition of three or four centers in 2H06. In 2007-08, revenue should continue to rise at a double-digit tempo and reach PLN 1.3bn, with help from flourishing Ukraine.

Sales 2003-08 (PLN '000)

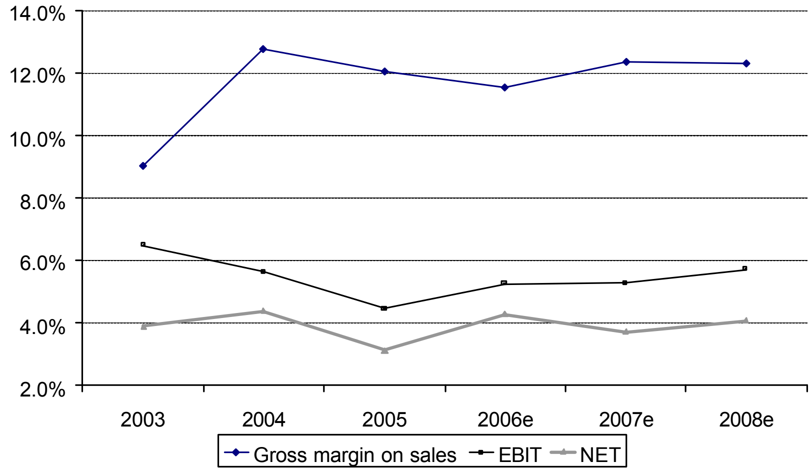


Source: Duda, Erste Bank

In order to achieve its plans, Duda needs to spend PLN 80mn in 2H06 and 2007 on pig farms, distribution centers, maintenance and the development of its current plant and Ukrainian operations. These outlays do not include the potential acquisition of a slaughterhouse.

We anticipate the gross margin on sales to stay just above 12% and EBIT advancing from 4.5% in 2005 to almost 5.7% in 2008, thanks to the much lower growth tempo of SG&A costs. The meat market will never show impressive margins, but the bottom line is generated on volume. Accordingly, Duda has ambitious plans to significantly increase the scale of its operations in all three sectors.

Margins



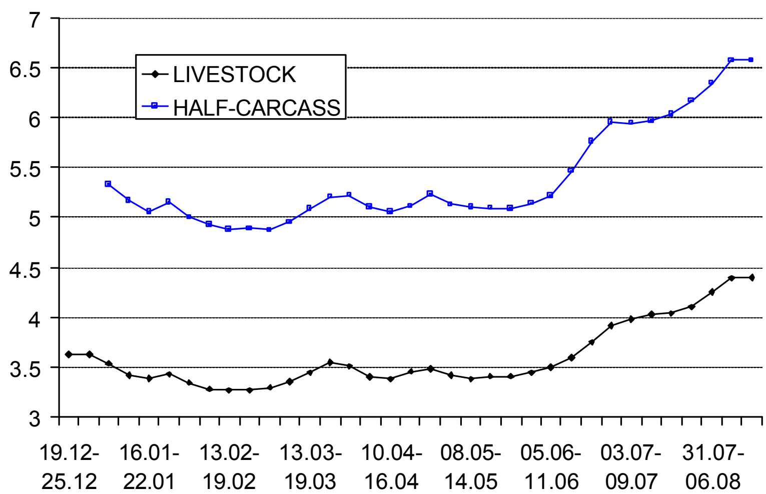
Source: Duda, Erste Bank

2006 net profit should surge by 64% y/y to PLN 44.3mn, helped strongly by a one-off item, namely the revaluation of real estate (PLN 8.5mn). Consequently, we forecast the bottom line at PLN 45.3mn in 2007. However, this does not include any non-recurring transactions.

Prices have rallied since February, peak expected in September

The average price per kg of pigmeat reached PLN 3.45 in 1H06. It started to climb steeply in February, from PLN 3.3 to the recent PLN 4.4 figure (up 33%). Independent forecasts show that the peak should be reached in September, after which prices will decline. On balance, we maintain our assumption of the average price at PLN 3.6 for FY06.

Pigmeat price (PLN/kg)



Source: Source: Agricultural Market Agency

Valuation

We employed a DCF model as our valuation tool to estimate the fair value of the company. The DCF is based on our forecasts for the years 2006-11. We adjusted cash flows and EBIT to reflect the cash impact of EU subsidies. The annual cash inflow differs from the corresponding position in other operating income reported in the P&L. It is booked under accruals and deferred income position in the balance sheet and than proportionally reported in P&L during the life of the investment. We used a discount rate based on WACC and a terminal value based on perpetuity. We discount all free cash flows for the firm on December 31, 2006 and subtract the forecasted net debt as of December 31, 2006. We then divide the equity value per number of shares. Afterwards, we compound this by the cost of equity (with the appropriate number of months). We thus arrive at a target price that represents our valuation of the stock price as it is expected to be 12 months into the future. The DCF led us to a target price of PLN 16.0 per share. The peer comparison indicates that Duda is currently traded at a 15% premium, which we believe is justified, given the company's growth prospects.

We based our valuation on the following assumptions:

- Slaughters will grow by 20% y/y in 2006; this number will increase 10% in 2007 and 2008
- Average price per kg will amount to PLN 3.6kg in 2006 and PLN 3.66kg in 2007
- Duda will add at least three distribution centers in 2006, and at least five in 2007
- Contribution of Ukrainian business to revenue will jump to PLN 70mn in 2009
- Perpetuity growth amounts to 1.2%
- Risk-free rate stands at 5.4% (yield of 5Y Treasury bonds), equity risk premium at 5.0%, debt risk premium at 2.0% and beta at 1.0.

Changes in forecasts

PLNmn	2006e			2007e		
	Now	Previously	Change	Now	Previously	Change
Revenue	1,040.7	1,017.0	2.3%	1,218.7	1,163.2	4.8%
COGS	-920.5	-881.0	4.5%	-1,068.3	-1,003.6	6.4%
Gross profit	**120.1**	**136.0**	**-11.7%**	**150.4**	**159.6**	**-5.8%**
S&GA	-83.7	-97.1	-13.9%	-97.0	-110.3	-12.1%
Other operating net	18.2	12.8		11.0	14.5	
EBIT	**54.7**	**51.6**	**6.0%**	**64.4**	**63.9**	**0.7%**
Financial net	-0.9	-8.1		-7.7	-8.6	
Net profit	**44.3**	**33.7**	**31.5%**	**45.3**	**43.3**	**4.7%**

Source: Erste Bank

WACC

	2006e	2007e	2008e	2009e	2010e	2011e	beyond 2011
WACC	**8.579%**	**8.629%**	**8.646%**	**8.640%**	**8.635%**	**8.645%**	**8.268%**
Equity cost	10.4%	10.4%	10.4%	10.4%	10.4%	10.4%	10.0%
Debt cost	6.1%	6.0%	6.0%	6.0%	6.0%	6.0%	5.7%
Equity weighting	57.2%	59.8%	60.2%	60.1%	59.9%	60.2%	60.0%
Debt weighting	42.8%	40.2%	39.8%	39.9%	40.1%	39.8%	40.0%
Risk free rate	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Debt premium	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Tax rate	17.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Erste Bank

DCF

	2006e	2007e	2008e	2009e	2010e	2011e	beyond 2011
EBIT	**54,691**	**64,376**	**75,227**	**82,650**	**87,784**	**93,634**	**93,634**
Tax rate	17%	19%	19%	19%	19%	19%	19%
Tax on EBIT	9,297	12,231	14,293	15,704	16,679	17,790	17,790
NOPLAT*	**42,461**	**49,284**	**58,073**	**64,086**	**68,244**	**72,982**	**75,843**
Depreciation	24,226	25,242	23,667	25,323	27,096	28,993	
Capital expenditures	60,000	57,500	23,667	25,323	27,096	28,993	
Change in working capital	13,572	19,303	10,805	7,804	6,306	6,624	
Free cash flow*	**552**	**2,109**	**51,654**	**56,282**	**61,938**	**66,359**	
Terminal value	1,095,226						
PV of FCF	0	1,942	43,767	43,896	44,467	43,850	
Sum of PV of FCF	177,922						
PV of terminal value	723,735						
Enterprise value	**901,657**						
Non-operating assets	0						
Net debt at 31.12.2006	174,690						
Fair value at 31.12.2006	**726,967**						
Number of shares	48,600						
Fair value per share at 31.12.2006	**15.0**						
Cost of equtiy	10.4%						
Target Price	**16.0**						
Stock price	13						
Premium/discount	26%						

** adjusted for non-cash/cash effects of EU subsidies; Source: Erste Bank*

Peers

	P/E 2005	P/E 2006e	P/E 2007e	EV/Sales 2005	EV/Sales 2006e	EV/Sales 2007e	EV/EBITDA 2005	EV/EBITDA 2006e	EV/EBITDA 2007e	Valuaiton 2005	Valuation 2006e	Valuation 2007e
Implied fair value	431,350	694,937	555,708	317,627	399,273	468,302	207,676	312,646	329,808			
Number of shares	48,200	48,200	48,200	48,200	48,200	48,200	48,200	48,200	48,200	**6.6**	**9.7**	**9.4**
Implied fair value per share	8.9	14.4	11.5	6.6	8.3	9.7	4.3	6.5	6.8			
12 month target price										**7.3**	**10.7**	**10.3**
Median for international peer group	**15.9**	**15.7**	**12.3**	**0.6**	**0.6**	**0.5**	**7.1**	**6.6**	**6.0**			
Nikas	15.00	15.21	12.61	1.6	1.5	1.3	6.6	6.1	5.3			
Ter Beke	14.83	14.63	10.47	0.5	0.5	0.5	5.5	6.1	4.8			
Hk Ruokatalo	16.83	13.99	12.31	0.5	0.6	0.5	9.2	8.3	7.1			
Cremonini SpA	19.62	18.23	14.11	0.4	0.4	0.3	6.8	6.3	5.8			
Devro International	13.52	13.84	12.20	1.5	1.3	1.3	7.4	7.0	6.2			
Atria Oyj	13.01	16.14	11.94	0.6	0.5	0.5	7.9	7.9	6.7			
Fleury Michon SA	16.85	20.51	18.94	0.5	0.6	0.5	4.9	5.5	4.9			
Sardus AB	18.24	17.83	10.79	0.8	0.7	0.6	9.3	9.3	7.2			

Source: JFC, Erste Bank

Income Statement (IAS, PLN mn, 31/12)	2004	2005	2006e	2007e	2008e
Sales revenues	**533.4**	**870.0**	**1,040.7**	**1,218.7**	**1,319.4**
Cost of goods sold	-465.4	-765.4	-920.5	-1,068.3	-1,157.1
Gross profit	**68.0**	**104.6**	**120.1**	**150.4**	**162.3**
SG&A	-47.6	-82.7	-83.7	-97.0	-99.0
Other operating, net	9.6	16.8	18.2	11.0	11.9
EBITDA	**39.0**	**53.7**	**73.3**	**84.0**	**98.9**
Depreciation	-8.9	-15.0	-18.6	-19.6	-23.7
EBIT	**30.1**	**38.7**	**54.7**	**64.4**	**75.2**
Financial result	-0.2	-6.3	-0.9	-7.7	-8.1
EBT	**29.9**	**32.5**	**53.8**	**56.7**	**67.2**
Tax expenses	-5.0	-6.1	-9.1	-10.8	-12.8
Extraordinary result	-0.2	0.0	0.0	0.0	0.0
Minority interests	-1.4	0.7	-0.3	-0.6	-0.6
Net result after minorities	**23.3**	**27.1**	**44.3**	**45.3**	**53.8**

Balance Sheet (IAS, PLN mn, 31/12)	2004	2005	2006e	2007e	2008e
Intangible assets	78.1	90.5	95.3	95.3	95.3
Tangible assets	140.2	168.2	209.6	247.4	247.4
Financial assets	12.2	10.7	24.3	24.6	24.8
Total fixed assets	**230.5**	**269.4**	**329.2**	**367.3**	**367.5**
Inventories	49.3	58.9	69.0	80.1	86.8
Receivables and other current assets	100.3	104.7	130.1	152.3	164.9
Other assets	1.4	1.9	3.1	3.7	4.0
Cash and cash equivalents	14.0	32.0	10.4	12.2	13.2
Total current assets	**165.0**	**197.5**	**212.7**	**248.3**	**268.9**
TOTAL ASSETS	**395.5**	**467.0**	**541.8**	**615.6**	**636.3**
Shareholders' equity	**178.1**	**206.7**	**247.6**	**293.4**	**302.2**
Minorities	**6.0**	**-0.3**	**0.0**	**0.5**	**1.1**
Other reserves	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Interest-bearing LT debts	56.6	103.0	111.1	118.6	120.4
Other LT liabilities	2.2	1.1	1.9	1.9	1.9
Total long-term liabilities	**58.8**	**104.1**	**112.9**	**120.5**	**122.3**
Interest-bearing ST debts	84.5	73.8	74.0	79.0	80.3
Other ST liabilities	68.1	82.7	107.2	122.2	130.4
Total short-term liabilities	**152.6**	**156.5**	**181.3**	**201.3**	**210.6**
TOTAL LIAB. & EQUITY	**395.5**	**467.0**	**541.8**	**615.6**	**636.3**

Cash Flow Statement (IAS, PLN mn, 31/12)	2004	2005	2006e	2007e	2008e
Cash flow from operating activities	-9.5	-0.4	43.3	56.7	77.3
Cash flow from investing activities	-85.3	-27.3	-63.8	-57.5	-23.7
Cash flow from financing activities	74.7	30.5	-1.1	2.6	-52.6
CHANGE IN CASH & CASH EQU.	**-20.1**	**2.9**	**-21.6**	**1.8**	**1.0**

Margins & Ratios	2004	2005	2006e	2007e	2008e
Sales growth	62.7%	63.1%	19.6%	17.1%	8.3%
EBITDA margin	7.3%	6.2%	7.0%	6.9%	7.5%
EBIT margin	5.6%	4.5%	5.3%	5.3%	5.7%
Net profit margin	4.4%	3.1%	4.3%	3.7%	4.1%
ROE	16.4%	14.1%	19.5%	16.8%	18.1%
ROCE	11.0%	7.9%	11.5%	10.1%	11.2%
Equity ratio	46.5%	44.2%	45.7%	47.7%	47.7%
Capital employed	313.4	352.2	424.2	481.2	492.8
Inventory turnover	14.2	14.2	14.4	14.3	13.9

Company Report

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Company	Disclosure	Comment
Duda	--	--

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Accumulate	+10% < target price < +20%
Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
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