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## Zarneni Hrani Bulgaria – Public Offering of 25%

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### General Information

Zarneni Hrani Bulgaria has been established on the bases of the state-owned Zarneni Hrani, which was the only Bulgarian structure engaged in purchase, storage and trade with grains till 1991. The activities of the company include also credits for farmers, fuel, fertilizers and chemicals, producing of bottled oil, dressings and biodiesel. In accordance with the requirements of EU on renewable energy sources, Zarneni Hrani Bulgaria invested in automated line for biodiesel production with capacity 100 000 tones per year in 2006.

Zarneni Hrani Bulgaria will offer 42 696 400 shares in the price range between BGN 4.40 and BGN 5.62 (EUR 2.25 and EUR 2.875). The size of the public offering is BGN 240 million (EUR 123.5 million) at the maximum price. The expected free-float is 25% in case of full subscription. The subscription for foreign players is in the period between 10<sup>th</sup> and 14<sup>th</sup> December, whereas for domestic investors is from 12<sup>th</sup> to 14<sup>th</sup> December.

The price will be determined by book-building.

### Business Description

Zarneni Hrani Bulgaria is the major grain buyer and dealer, operating on the territory of Bulgaria. The total grain and oilseeds traded by the company for 2006/2007 is up to 300 000 tones, nearly 5% of the total agricultural production. The expectations are the revenues from grain trade to set up 50% from the total revenues for the next five years.

Zarneni Hrani Bulgaria has four main activities:

- trading and storage of grain crops;
- trading and storage of oilseeds crops;
- production and trading with edible oil;
- wide spectrum of supplementary services.

The company is covering the complete cycle of the agricultural production – from the farmer to end product and controlled 700 000 tones grain storage, which is 35% of the registered capacity in Bulgaria. Zarneni Hrani Bulgaria owns 18 grain bases, located in the main grain producing regions of the country and near the main export corridors used for grain transportation. The logistic is a connecting link between all components in the operating pattern of the company, which allows reducing of the costs for transportation and support the export expansion. Zarneni Hrani Bulgaria owns 75% from Port Balchik and is participating in the construction of Lesport port.

### Market Position

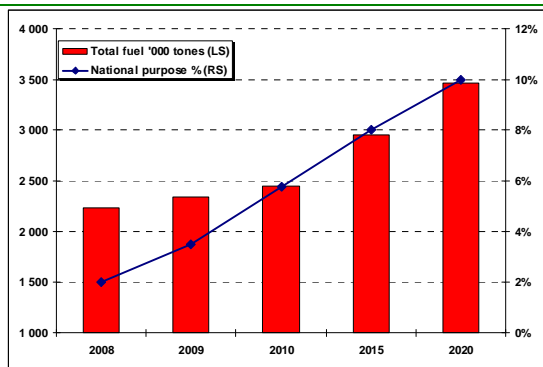
Several multinational companies operated in the same sector in Bulgaria like Zarneni Hrani. Only one of them – Bunge, owns assets in the country but ceased its operations in Bulgaria in 2007. The main competitors in the grain trade are Papas Oil and Bisser Oliva. After starting the manufacturing of biodiesel oil, Zarneni Hrani Bulgaria will become the largest manufacturer in the country. The capacity of 100 000 tones of biodiesel oil a year makes up nearly 60% of the total capacity in Bulgaria.

The geographical position allows the company to buy grains and oilseeds throughout the country. It provides significant competitive privilege and reduces the risk of crop failure in certain areas of the country.

**Biodiesel Market**

According to European Union Directive 2003/30 the national goals for biofuel usage are:

- indicative goal of 5.75% biofuel usage till 2010
- minimal requirements of 10% usage of biofuels in the total consumption of petrol and diesel in the transport for all members of EU till 2020.



Source: Ministry of Agriculture

The total energy balance begun to render an account of the consumption of biodiesel as of 2006, when 9 562 tones biodiesel were used. In a process of manufacturing are installations with producing capacity, respectively:

- for biodiesel – 415 000 tones till 2010
- for bioethanol – 95 000 tones till 2010

Based on the expectation that local demand will not be able to follow the fast growth in production, Zarneni Hrani Bulgaria considers exporting about 40% of its production. The company is already in negotiations with the leading fuel distributing companies in the region (Lukoil, OMV, Shell, Rompetrol etc) and is actively exploring the marketing opportunities in the EU. The business plan for 2008-2012 of Zarneni Hrani is entirely build upon the size of Bulgarian crop. However, Bulgarian production of crops for biodiesel and bioethanol could not satisfy the demand from planned capacity. The import of feedstock should close the gap between higher biofuel capacity and domestic production of oil plants. Rising prices of oil feedstock are the main problem for companies like Zarneni Hrani, which don't produce its raw materials. This could lead to low capacity utilization or even unprofitable production. The mandatory legal requirements in EU are creating significant demand for oilseeds, which is pushing up prices. This represents the main risk for Zarneni Hrani.

In order to broaden access to the crop, the flexibility and crop failure risk diversification, the company's strategy forecasts a geographical expansion in the near-by countries. Romania is gathering in about two times more than Bulgarian crops and gives significant opportunities for trade. The silos of Zarneni Hrani Bulgaria are situated near the border and are well positioned to store grains and oilseeds produced in Romania's major grain growing region – North Dobrudja. There are two main drivers behind the estimated crops growth:

- for Bulgaria: 2.5% planted area and 2% yield growth rates;
- for Romania: 2% yield growth rate.

The increase in the planted areas and the inputs usage are the drivers behind the growth of the company sales of fertilizers and pesticides for 2008-2012. The income from fertilizers and pesticides distribution forms about 5% of the total sales.

## IPO Procedure and Timeframe

Zarneni Hrani Bulgaria will offer 42 696 400 shares in the price range between BGN 4.40 and BGN 5.62 (EUR 2.25 and EUR 2.875). The size of the public offering is BGN 240 million (EUR 123.5 million) at the maximum price. The subscription for foreign players is in the period between 10<sup>th</sup> and 14<sup>th</sup> December, whereas for domestic investors is from 12<sup>th</sup> to 14<sup>th</sup> December.

During the road-show in Bulgaria, the leading manager Central Cooperative Bank announced its preferable structure of investors – half of the issue for foreign investors and ratio of 9:1 for institutional investors and physical persons. However, the allocation proportion will be determined by the demand and the manager is retaining the flexibility to achieve different structure of investors.

### Oversubscription

The oversubscription will depend of the interest from foreign institutional investors. Domestic speculators won't be able to absorb the total issue and institutional investors could be cautious given the current valuation of Zarneni Hrani.

## Financial Situation and Projections

The historical data from 2004 to the 9 months of 2007 are aggregate from the financial statements of the eight companies that were merged. However, the data exclude all possibilities of gains from mergers and cost cutting. The projected sales and profits in the company's business plan for 2008-2012 are used for our DCF model and to calculate multiples.

BGN'000	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Sales</b>	42 081	56 279	119 743	124 512	285 733	446 365	597 623	693 360	756 800
<b>Sales Growth</b>		33,74%	112,77%	3,98%	129,5%	56,2%	33,9%	16,0%	9,1%
<b>EBITDA</b>	12 295	13 093	25 689	16 560	27 926	39 607	51 828	68 523	83 649
<b>EBITDA Margin</b>	29,2%	23,3%	21,5%	13,3%	9,8%	8,9%	8,7%	9,9%	11,1%
<b>Depreciation</b>	195	282	394	1 025	1 025	1 025	1 265	1 505	1 505
<b>EBIT</b>	12 100	12 811	25 295	15 535	26 901	38 582	50 563	67 018	82 144
<b>EBIT Margin</b>	28,8%	22,8%	21,1%	12,5%	9,4%	8,6%	8,5%	9,7%	10,9%
<b>EBT</b>	9 722	10 470	24 637	12 966	24 163	34 753	47 393	63 095	77 615
<b>Net Profit</b>	9 558	10 522	24 442	12 273	21 746	31 278	42 653	56 785	69 853

Source: Zarneni Hrani

Zarneni Hrani is aiming to gain rapidly market share in all its activities. Trading with grains and oilseeds will gradually lose share in the structure of revenues. The revenues of biodiesel will represent 42% of total sales in 2012, whereas grain trading will be 39%. The expected profit margins for the two main segments are 13-14% for biodiesel and 7-8% for grain trading. Both activities will depend heavily on the prices of grains and oilseeds. The seasonal pattern for strong sales during the forth quarter will be subdued as grain trading will become the second largest segment.

000'mt	2008	2009	2010	2011	2012
<b>Origination</b>					
Oilseeds	205	290	360	450	520
% of the crop	21%	27%	31%	35%	36%
Grains	270	430	540	630	720
% of the crop	5%	7%	9%	10%	11%
<b>Sales</b>					
Biodiesel	51	99	162	198	198
% market share	57%	58%	70%	66%	66%
Refined oil	12	15	21	27	30
% market share	13%	17%	23%	30%	33%
Oilseeds	125	110	72	50	52
Grains	240	410	510	610	720
Meal	-	55	134	123	157
Fertilizers	20	30	40	50	60

Source: Zarneni Hrani

### Valuation by Multiples

The indicative price range is BGN 4.40 to 5.62 (EUR 2.25-2.875). For valuation purposes we represent the multiples calculated on trailing twelve months basis and with the expected financial data for 2007 and 2008. We include also comparison with large international peers and DCF model based on the company's projections.

The indicative price range of BGN 4.40 to 5.62 (EUR 2.25-2.875) is resulting to market capitalization between BGN 750 and 960 million. This is 6 to 7 times revenues for the last twelve months. The company is offered for sale at higher P/E ratio than the average for the Bulgarian market. EBITDA are slightly higher than net profit due to the small depreciations and interest payments. Company's Enterprise Value (EV) is mainly influenced by the market capitalization. EV/EBITDA at the price range stood between 28 and 34.

Price	4,40	5,62
Number of Shares	170 785 600	170 785 600
Market Cap	751 456 640	959 815 072
Net Profit	25 644 000	25 644 000
P/E	<b>29,30</b>	<b>37,43</b>
Revenues	131 042 000	131 042 000
P/S	<b>5,73</b>	<b>7,32</b>
Equity	174 800 000	174 800 000
P/B	<b>4,30</b>	<b>5,49</b>
EV	841 194 640	1 049 553 072
EBITDA	30 281 000	30 281 000
EV/EBITDA	<b>27,78</b>	<b>34,66</b>
EV/Revenues	<b>6,42</b>	<b>8,01</b>
P/EBITDA	<b>24,82</b>	<b>31,70</b>

Source: ZHBG;  
Calculations: ELANA Trading

Results on trailing basis are influenced by the solid net profit during the last quarter of 2006. However, the expectations for the 2007 are for lower net profits comparing to the previous year. This results to even higher P/E and EV/EBITDA ratios than those calculated on ttm basis. We made slight adjustments to equity and EV to include the total net profit for 2007. The company is offered at 50 times EBITDA for 2007. The expected revenues for 2007 are slightly lower than those calculated on ttm basis and 4% higher than sales during 2006. All multiples are higher than average for Bulgarian stocks.

Price	4,40	5,62
Number of Shares	170 785 600	170 785 600
Market Cap	751 456 640	959 815 072
Net Profit	12 273 000	12 273 000
P/E	<b>61,23</b>	<b>78,21</b>
Revenues	124 512 000	124 512 000
P/S	<b>6,04</b>	<b>7,71</b>
Equity	180 724 000	180 724 000
P/B	<b>4,16</b>	<b>5,31</b>
EV	835 270 640	1 043 629 072
EBITDA	16 560 000	16 560 000
EV/EBITDA	<b>50,44</b>	<b>63,02</b>
EV/Revenues	<b>6,71</b>	<b>8,38</b>
P/EBITDA	<b>45,38</b>	<b>57,96</b>

Source: ZHBG;  
Calculations: ELANA Trading

The expected improvement in sales in 2008 will push down the P/S ratio to more acceptable level for the market. However, the main source of revenues is grain trading, which has lower profit margins than other operations of Zarneni Hrani.

Price	4,40	5,62
Number of Shares	170 785 600	170 785 600
Market Cap	751 456 640	959 815 072
Net Profit	21 746 000	21 746 000
P/E	<b>34,56</b>	<b>44,14</b>
Revenues	285 733 000	285 733 000
P/S	<b>2,63</b>	<b>3,36</b>
EBITDA	27 926 000	27 926 000
P/EBITDA	<b>26,91</b>	<b>34,37</b>

Source: ZHBG;  
Calculations: ELANA Trading



**Valuation**

The fair price, which is based on the comparison to liquid Bulgarian shares and the DCF model, is showing twice lower price than the indicative range. When comparing to peers, price should be even lower. The valuation methods are excluding the effects of synergy in the group but could be embedded in the expected results for 2008. The public offerings with indicative price ranges in Bulgaria so far, proved to be priced in the range.

Method	Value	Price	Weight
<b>Multiples</b>			
P/E - 2007	30	2,16	10%
forward P/E	25	3,18	10%
P/S - 2007	2	1,46	10%
forward P/S	1,5	2,51	10%
EV/EBITDA	12	0,67	10%
<b>DCF</b>		2,70	50%
<b>Price (BGN)</b>			<b>2,35</b>

Calculations: ELANA Trading

**Price Targets**

The public offering of Zarneni Hrani is relying mainly on the future expectations for solid growth of sales and profits. Our valuation showed lower price than the indicative range and we cannot give a price target based solely on the expected average multiples or expected cash flows. Bulgarian market is very tolerant to fast developing companies but Zarneni Hrani should exceed significantly its projections to justify further price gains of its shares.

Moreover, the company is planning to develop a relatively new industry for Bulgaria – the production of biodiesel but without to ensure the production of required oilseeds. The capacity in the sector will quickly exceed the demand in Bulgaria and will add the risk of insufficient domestic market and competitive export markets in the region.

Before setting up the price targets, we would like to see the oversubscription (if any is available) and the price of the execution. The secondary trading will begin during the last trading week this year and will also give the idea of the speculative and investment interest. No doubt, Zarneni Hrani will be traded at higher than average multiples for Bulgarian stocks. We cannot exclude the possibilities of short term speculative gains but price gains seem very limited at the current valuation ratios and the expected large free-float.

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<b>Outperform</b>	More than 5% higher as compared to SOFIX and BG40 performance
<b>Market Perform</b>	Market performance, +/-5% as compared to SOFIX and BG40
<b>Underperform</b>	More than 5% lower as compared to SOFIX and BG40 performance

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