
MEKOM IPO

General Information

Mekom is the largest meat exporter in Bulgaria and is the only Bulgarian company with all export licenses for European Union, including Class A. Mekom has a wide range of meat products traded under different trade marks and is the executive distributor of the Italian company "Montana" for the Bulgarian market.

Mekom will offer up to 10 682 800 shares at the minimum price of BGN 2.20 through the method of book-building. The subscription will be between 21st and 23rd January, 2008 and the payment period is up to 29th January.

This research note will provide short description of Mekom's current projects, the IPO procedure and timeframe as well as the company's current financial data and the management's projections. The valuation of Mekom at the IPO price is based on multiples.

Business Description

The main activity of Mekom is meat production, meat processing and selling of live animals. The company is covering the complete cycle of the meat production and is along several companies with own complexes, which guarantee the deliveries of live animals. The company has twelve subsidiaries; nine are engage in trading, breeding and selling of animals. The other subsidiaries are working in meat processing, distribution and selling of meat. Mekom provided active research and development policy through "Silistra Hibrid", including selection of own races with higher quality.

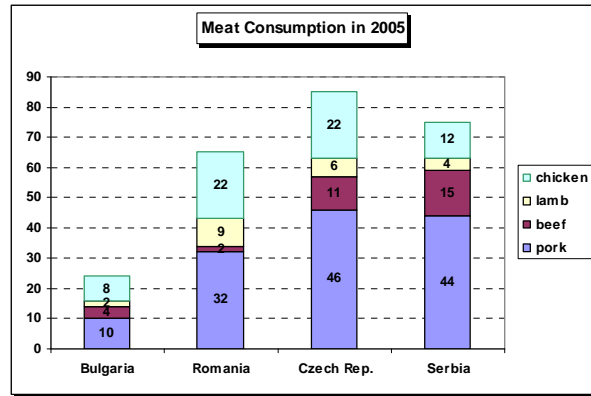
Mekom plans to increase its positions in traditionally strong segments and to keep and increase its market share. The company will continue to focus in high price segment toward finished products but they don't expect to increase the share significantly in future. Mekom has capacity to increase significantly the number of breed animals and the meat processing, which make the expectations in the business plan until 2012 completely achievable. The capacity utilization of the slaughterhouse for pork is 40%, for cattle is 20% and for lamb is 75%. The forbidden export toward EU will fall away in March, which will allow the company to increase its presence in this segment.

Mekom plans to enter the Romanian meat market through partnership with domestic deliverer or through own distribution network. The investment costs are at total amount of BGN 22 m to the end of 2009. The biggest part is for:

- buying a company for meat processing - BGN 7 m ;
- entering the Romanian market – BGN 5 m;
- modernizing the existing plants – BGN 4m.

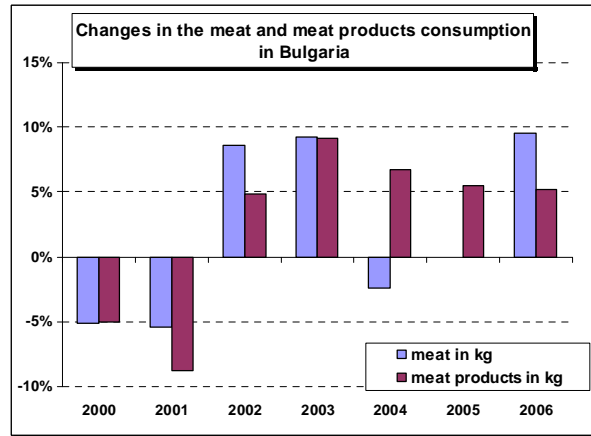
The rest resources will be used for modernizing the buildings, marketing and for staff training. Additionally, the company plans to acquire slaughterhouse in Serbia or Croatia, which will make easier the access to the law materials and to cut the transport costs for the chilled meat. The revenues from the IPO won't be use for covering of liabilities.

The meat consumption in Bulgaria is still below the consumption in Central and Eastern Europe, which shows the potential for growth of the domestic market. The larger part of the supply production of live animals is imported as the domestic production can not satisfy the demand from meat processing plants. Bulgaria and Romania consume more chicken meat as compared to Serbia and Czech Republic. Increasing of the pork and beef meat consumption is possible, following larger overall consumption.



Source: Mekom

Mekom company expects Bulgarian market to follow the European trends toward higher meat consumption per capita, along with rising purchasing power of households. The consumption of meat and meat products is constantly increasing from 2002, according to the data of National Statistical Institute. The inflationary pressure to foods is accelerating during the period, which guaranteed nominal rise of 10-15% y-o-y from that period. We expect food prices to remain under upward pressure in 2008 due to the higher grain prices and the rising oil prices.



Source: NSI

IPO Procedure and Timeframe

Mekom will offer 10 682 800 ordinary shares at the minimal price of BGN 2.20. The price will be determinate through the method of book-building and all shares will be allocated proportionally to the orders. The subscription is between 21st and 23rd January, between 9 a.m. and 4 p.m. Bulgarian time. The price and allocation will be announced on January, 24th and the payment period is up to January, 29th.

If the IPO is successful the shares of Mekom will amount 64 m, and the market capitalization will be BGN 140.8 m at the minimum price.

Leading manager of the issue is United Bulgarian Bank, and Allianz Bulgaria will be a co-manager.

Oversubscription

The oversubscription is very interesting question during the current market correction and the attractive multiples of liquid companies. Mekom has growth opportunities which balance the higher than average P/E for Bulgarian market. Expected sales are achievable due to the modernizations as well as due to the free capacity. The low cash in speculators and the cautious foreign and domestic investors may limit the oversubscription.

Financial Situation and Projections

The company retained growth rates by 20%-30% per year. The consolidated data for previous years are the aggregation of the companies in the structure of Mekom. Sales and profits as of 2007 are important for the projections and price estimations. The financial results for the first nine months of 2007 exceeded the total results for 2006. Moreover, the global meat assumption at the end of 2007 will reflect in better 4Q 2007 results, which will be announced after the IPO. The company will exceed its projections for 2007 and we expect even higher sales due to the inflation.

	000	2004	2005	2006	3Q'07
Sales		24 926	33 417	46 773	53 393
Other sales		1 093	1 165	5 292	74
Financing		708	808	1 411	675
Revenues		26 727	35 444	53 476	54 142
D&A		2 640	3 087	3 461	2 495
EBITDA		5 670	7 963	7 844	7 346
Interest		1 833	2 713	1 564	1 397
EBIT		3 030	4 876	4 383	4 852
EBT		1 197	2 163	2 819	3 455
Net profit		967	1 856	2 451	3 455
Assets		44 229	57 666	63 008	61 296
Fixed Assets		32 433	40 115	35 722	34 328
Current Assets		11 796	17 551	27 286	26 968
Equity		5 797	7 638	9 894	14 363
Liabilities		38 432	50 028	53 114	46 933
Long-term liabilities		23 631	28 197	24 142	27 314
Short-term liabilities		14 801	21 831	28 972	19 619
Bank loans		4 205	4 786	10 367	184

Source: Mekom

Estimated financial results of Mekom for the next five years are based on sales growth to BGN 212 m. They include operations, which are in process of development or are opportunity for sales growth (export for Russia; European grants for breeding of animals; expansion on the Balkans; export and processing of other meats). Mekom estimates 30% sales growth in the next three years, which is higher as compared to the projections for 2007. 3Q financial results exceeded the results for 2006 and the significant export before the New Year holidays additionally boosted the growth. Moreover, the profit margin during the 4Q is improving despite the higher grain prices. Estimations also include the interest revenues from the accumulated cash. The free cash will probably be invested in company's future development, whereas Mekom has opportunities for additional sales and organic growth. The estimations for sales and profits will be used for our discounted cash flows model to determine the company's valuation.

Mekom is not planning to distribute dividends in the next several years.

`000	2007	2008	2009	2010	2011	2012
Sales	64 410	84 869	116 093	147 669	181 420	212 400
Gross profit	17 592	23 782	33 073	42 949	53 665	64 092
% of Sales	27.31%	28.02%	28.49%	29.08%	29.58%	30.18%
Administrative costs	8 076	12 644	16 555	19 515	24 747	28 631
EBITDA	9 516	11 138	16 518	23 434	28 918	35 461
% of Sales	14.77%	13.12%	14.23%	15.87%	15.94%	16.70%
D&A	-3 714	-4 704	-4 812	-4 889	-4 967	-5 044
EBIT	5 803	6 434	11 706	18 545	23 951	30 417
% of Sales	9.01%	7.58%	10.08%	12.56%	13.20%	14.32%
Interest	-1 073	-563	-568	-5	548	1 689
Income before taxes	4 730	5 871	11 138	18 540	24 499	32 106
Taxes	-473	-587	-1 114	-1 854	-2 450	-3 211
Net profit	4 257	5 284	10 025	16 686	22 049	28 895

Source: Mekom

Valuation by Multiples

The valuation of Mekom is based on the popular multiples – P/E, P/S and P/B. The discounted cash flows analysis represents the main tool for the valuation as they implement better the growth opportunities of the firm.

The multiples in the table are calculated by the Mekom's projections for 2007 and 2008 and the minimum price for the IPO of BGN 2.20. We expect better performance for sales in 2007 and a net profit which will slightly exceed projections. This will improve a bit the high values of P/E, EV/EBITDA and P/EBITDA after the announcement of consolidated financial statement and higher revision for the 2008 expectations.

The P/B is 2.19 and decreases to 1.66 when including the expected 2008 net profit and all capital raised by the IPO. This is relatively low value for public offerings in Bulgaria.

000	2007	2008
Net Profit	4 257	5 284
EBIT	5 803	6 434
EBITDA	9 516	11 138
Sales	64 410	84 869
Equity	57 671	86 458
Market Cap	141 013	141 013
Cash	2 973	21 180
Debt	26 649	35 783
EV	164 689	155 616
P/E	33.12	26.69
P/S	2.19	1.66
P/B	2.45	1.63
EV/EBITDA	17.31	13.97
EV/Sales	2.56	1.83
P/EBITDA	14.82	12.66

Calculations: ELANA Trading

Peers Comparison

The comparison to foreign companies in the meat processing industries should be implemented with the considerations of regional differences, vertical integration, the product portfolio, growth opportunities and the profit margins, which could vary substantially for the companies in our selection. This is the reason not to calculate the valuation of Mekom through the average multiples of the companies in the following table.

Most foreign companies are currently trading below their revenues. As a result, the P/E ratios are lower, despite their disadvantage in EBITDA margin, as compared to Mekom's historical results and projections for the next five years. Most international peers are producing wide variety of sausages which decrease the profitability.

Company	Country	P/E	P/B	P/S	EV/EBITDA	RoA	RoE	EBITDA Margin
Kreka	Greece	87.7	1.03	0.57	14.28	0.40%	0.82%	8.69%
PG Nikas	Greece	n/a	3.2	0.79	18.17	-3.91%	-16.65%	7.34%
Zaklady Miesne Beef-San	Poland	29.24	1.29	0.46	12.62	3.69%	7.16%	3.03%
Duda	Poland	8.47	2.02	0.46	7.82	7.00%	13.77%	6.83%
Campofrio Alimentacion	Spain	15.13	2.75	0.47	6.54	2.67%	9.25%	9.47%
Moksel	Germany	28.45	3.6	0.09	5.24	1.22%	5.36%	1.92%
Cranswick	UK	15.53	14.77	0.66	9.2	8.53%	18.62%	8.52%
Gruppa Cherkizovo	Russia	15.87	3.27	1.16	12.83	7.46%	20.62%	12.78%
OMPK	Russia	19.33	3.8	0.35	13.83	10.34%	21.66%	2.86%

Source: Reuters

Discounted Cash Flows

Discounting of the cash flows gives better picture for the price, according to the growth opportunities as the long-term perspectives are not included in the multiples P/E and P/B.

Our DCF model is based on the management's projections for the next five years and on the decelerating growth rates to the end of the ten-year period. The projected long-term growth rate is 2.5% with WACC of 12%. The discount rate could be higher as the BSE is very volatile at the moment and investors could be requiring more risk premium.

The model gives a price per share of BGN 2.94. This is higher than the other used methods.

Mekom											Terminal
<i>BGN'000</i>	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Year
EBIT	6 434	11 706	18 545	23 951	30 417	33 304	36 635	39 566	41 939	43 617	44 707
EBIT(1-T)	5 791	10 535	16 691	21 556	27 375	29 974	32 971	35 609	37 746	39 255	40 237
Add: D&A	4 704	4 812	4 889	4 967	5 044	5 947	6 542	7 065	7 489	7 789	7 983
Less: Investments	18 000	4 000	4 889	4 967	5 044	5 947	6 542	7 065	7 489	7 789	7 983
Less: Change NWC	4 092	6 245	6 315	6 750	6 196	5 098	4 758	4 187	3 391	2 397	1 597
FCF	-11 597	5 103	10 375	14 806	21 179	24 876	28 214	31 422	34 354	36 859	38 640
PV FCF	-10 355	4 068	7 385	9 409	12 018	12 603	12 762	12 691	12 388	11 868	
Sum of PV FCF	84 837										
PV of Continuing Value	130 958										
Total PV Free Cash Flows	215 796										
Less: Outstanding Debt	27 498										
PV of Equity	188 298										
Number of Shares	64 097										
Price Per share	2.94										
			WACC		Growth Rate						
				SA	1.5%	2.0%	2.5%	3.0%	3.5%		
				10.0%	3.83	3.99	4.18	4.39	4.63		
				11.0%	3.23	3.35	3.48	3.63	3.79		
				12.0%	2.76	2.84	2.94	3.04	3.16		
				13.0%	2.37	2.43	2.50	2.58	2.67		
				14.0%	2.05	2.10	2.15	2.21	2.27		

Calculations: ELANA Trading

Valuation

Calculations by the most popular multiples P/E, P/B and EV/EBITDA and the calculations based on DCF model show a fair price of BGN 2.46. The results exclude the required discount before the public offering and are largely influenced by the expectations for future sales growth.

Method	Value	Price	Weight
Multiples			
P/E - 2007	25	1.66	10%
forward P/E	20	1.65	10%
P/S - 2007	2.5	2.52	10%
forward P/S	2	2.65	10%
EV/EBITDA		1.41	10%
DCF		2.94	50%
Price (BGN)			2.46

Calculations: ELANA Trading

Price Target

The valuation before the IPO is not including the possibility of exceeded projections for 2007 and 2008 and the required premium from investors. The minimum price of BGN 2.20 is neither too attractive investment, neither represents the intentions of the majority owner to sell it at too high price.

The price target for one year period will depend on the net profits along with the sales growth. Many Bulgarian companies are in the period of strong growth but their P/E ratios are unlikely to fall below the market average. This is not the reason to expect that investors are open to another company with low profits comparing to their market prices. Moreover, recent market turmoil is making investors less reluctant to bid fiercely on the IPO.

The oversubscription and the start of the secondary trading will show how acceptable for the market is the higher P/E of Mekon. We can revise our price target on the upside from the current levels between BGN 2.65 (2 forward P/S) and BGN 2.94 (the price of the discounted cash flows).

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