

PLN 103.4

Buy

Target price PLN 125

WIG index

63,527

of shares

12.6m

MCAP

PLN 1,329m

US\$ 475m

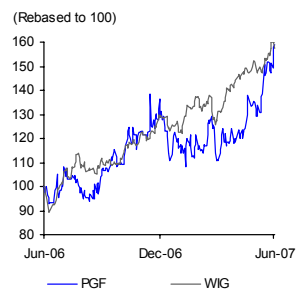
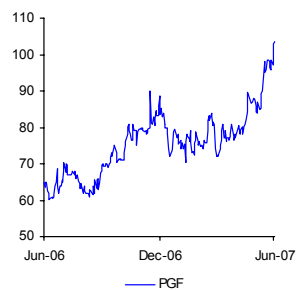
Free float

PLN 1,013m

US\$ 362m

MDIC.WA / PGF.PW

NB. Pricing as of 7 Jun 2007

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8 June 2007

Re-initiating coverage

PGF

Pharmaceuticals & Biotech

Poland

Volume and retail: *best of both worlds?*

PLNm	2005	2006	2007E	2008E	2009E
Revenues	3,891	4,006	4,227	4,293	4,485
EBITDA	93	108	111	127	142
Net profit	53	63	70	82	96
EPS (PLN)	4.26	5.04	5.46	6.40	7.44
P/E (x)	24.3	20.5	18.9	16.2	13.9
EV/EBITDA (x)	16.9	13.9	13.2	11.1	9.5
Dividend yield (%)	2.1	2.3	2.3	2.4	2.6
DPS (PLN)	2.20	2.40	2.40	2.50	2.70

Shareholder Structure: J. Szwajcowski 10.5%, Z. Molenda 5.8%, KIPF 7.4%, CU OFE 10.6%, ING NN OFE 9.2%, Julius Bear IM 8.8%

- **PGF is the largest wholesaler of pharmaceuticals in Poland, with an estimated 19% market share and the largest chain of independently operated pharmacies, numbering over 1,600, under the common brand "DoZ". Economies of scale and use of the most-advanced logistics solutions coupled with an aggressive acquisition strategy have yielded a 29% earnings CAGR for 2003-2006. Its reorganised retail distribution arm should boost the company's bottom line by another 15% CAGR up until 2010. We are re-initiating coverage of PGF with a BUY rating and a 12M price target of PLN 125.**
- **The company's outstanding earnings CAGR 2003-2006 of 29% have been driven so far by economies of scale and efficiency gains in the wholesale business segment: points for the management; yet peak operating efficiency still lies ahead.**
- **Earnings boost fuelling 15% net profit CAGR through 2009 should come from PGF's retail pharmacies. PGF's chain stores contributed strongly to the top line in 2006 (sales up 26% YoY), but not so much to profits. With the conclusion of the restructuring process, pharmacy location upgrades and rebranding, PGF's retail business is set to fire up, in our view.**
- **Bottom line? Broadest exposure to rising sales of pharmaceuticals (particularly in OTC segment, up 18% YoY as of April 2007) plus mounting contribution of the high-margin retail business. All backed by management's outstanding track record, evidenced by the company's consistent earnings growth and a dividend (yield of 2.3%).**
- **PGF is trading at our estimated 2008E P/E of 16x and 2009E P/E of 14x, which implies a 7% and 13% respective discount to its European counterparts. We are re-initiating coverage of PGF with a Buy rating and our 12-month price target of PLN 125, yielding an upside of 20%.**

Please note that the information at the back forms an integral part of this report.

See disclaimer for more information on UniCredit Markets & Investment Banking.

Investment summary

<p>Valued for leading market share in wholesale... deserving credit for retail operations</p>	<p>Valued primarily for its leading position in the pharmaceutical wholesale distribution market, PGF's second most value-accretive business segment remains underappreciated, in our view. We believe PGF's key earnings booster in coming years will turn out to be its retail distribution channel, which is on the verge of being fired up. Planned legislative changes, which effectively ban the creation of new pharmacy chains in Poland are most likely to freeze the status quo, thereby enhancing the value of both PGF's proprietary pharmacy chain as well as its unique virtual chain of independently operated drug stores grouped under the brand name "DoZ".</p>
<p>Pharmaceuticals market share of 19%</p> <p>Outstanding earnings growth 2003-2006 CAGR of 29%</p>	<p>Since its public listing on the WSE (Warsaw Stock Exchange) in 1997, PGF has actively consolidated the pharmaceutical distribution market, acquiring smaller wholesalers as well as pharmacy chains. Its market share in the wholesale distribution market quickly reached 19% but profitability of the PGF Group lagged behind due to ongoing restructuring of the acquired entities. The company's first considerable results improvement came in 2002. Since then PGF's earnings have soared at a 2003-2006 CAGR of 29%.</p>
<p>Profit margin expansion driven by economies of scale... retail boost ahead</p>	<p>Driven by economies of scale and the use of the most up to date logistics solutions, PGF has become one of the most efficient and competitive drug distributors in Poland while maintaining its 19-20% market share. Its net profit margin climbed to 1.6% in 2006 (from 0.7% in 2002), which is close to the margin level of its European peers. Last year, PGF's ROIC increased to 12.3% from 11.1% a year earlier. The company's peak efficiency still lies ahead, though, since its results have yet to be affected by the impact of its reorganised retail pharmacies.</p>
<p>Sales of PGF's retail arm up 26% YoY in 2006</p> <p>Impact on profit mounting... 30% of EBITDA by 2009E</p>	<p>Sales of PGF's retail arm have increased by 26% YoY in 2006 and accounted for 15% of total revenues while contributing only 2% to the company's EBITDA. With the conclusion of the restructuring process, pharmacy upgrades and rebranding, the retail business unit is just gaining momentum earnings-wise. The average pharmacy is more than twice as profitable as the wholesaler on the gross profit level and despite the inherently higher SG&A costs, the impact of growing sales (at an above-market pace) in this business segment should strike doubly hard, providing a boost to PGF's earnings. We estimate that retail sales should account for 18% of the company's total revenues and 30% of its EBITDA by 2009E.</p>
<p>Play on growing consumer spending</p> <p>OTC sales up 18% YTD in Poland</p> <p>PGFs pharmacies reorganised to accommodate demand... sales up 20% in selected locations</p>	<p>Increased consumer spending, particularly in the OTC (Over the Counter) drugs area, should provide further support for above market growth rates in PGF's pharmacies. While consumption of prescribed medicine is fairly stable, sales of OTC pharmaceuticals have grown at the rate of 18% (YTD as of April 2006), exceeding that of the overall market (ca. 9% respectively). PGF's pharmacies are well-advanced in the process of upgrading and relocating the OTC drugs and paramedical supplies from "behind the counter" into self service zones. Initial effects of the reorganised floor space are inspiring, with average sales growth exceeding 20% in the overhauled store locations.</p>
<p>Key risk: pharmaceutical law changes</p> <p>We expect the proposal to be amended or rejected</p>	<p>Regulatory actions aimed at reducing the statutory profit margins on prescribed pharmaceuticals as well as planned legislative changes aimed at separating the wholesale business from retail pharmacy chain operations constitute the primary risks for most drug distributors. While the government scheduled 0.23pp wholesale profit margin reduction affects all of the distributors in the same manner, separation of the retail from the wholesale arms with the proposed mandatory disposal of the pharmacies by wholesalers concerns only PGF and Farmacol of all the listed distributors. Proposed changes to pharmaceutical laws would require distributors to sell (during a five-year period) their stores in the states where they control over 1% of the total number of pharmacies. We expect these overly protectionist solutions to be either a) amended at the parliamentary reading or b) rejected by the senate.</p>

Proposed (effective) ban on future pharmacy chain creation?

Enhances value of the Polish largest "virtual" chain under DoZ brand

Proposed changes to pharmaceutical laws, while unfavourable to the industry, should have a positive effect on the valuation of the existing pharmacy chains, i.e. paradoxically for PGF as well. Once the "grandfathered" privileges are recognised the status quo should remain while the market should be blocked for newcomers. This in turn should increase the value of the existing pharmacy chains including the largest one operated by PGF under the brand "DoZ." Including PGF's proprietary stores, the "DoZ" branded group of pharmacies includes over 1,600 locations, or about 13% of the total drug store population in Poland. This virtual chain (most of the stores are owned and operated independently of PGF) provides a direct marketing platform for pharmaceutical producers and in the future may prove an invaluable tool in acquisition of contracts with the private healthcare insurance companies (allowing private insurance companies is one of the potential solutions considered by the government as an antidote for an ailing healthcare system).

**PGF trading at:
2008E P/E 16x
2009E P/E 14x
discount 7%, 13% resp.**

**Price target: PLN 125
Upside 20%**

PGF is trading at our estimated 2008E P/E of 16x, dropping to a 2009E P/E of 14x, at which time we expect to see the full effect of the reorganised retail pharmacy business. This implies that PGF is trading at a 7% discount to its west European peers on 2008E P/E and at a 13% discount on our estimated 2009E P/E. The current price also includes a proposed dividend of PLN 2.40 per share yielding 2.3%. We are reinstating coverage of PGF with a BUY rating and target price of PLN 125, which offers 20% upside.

PGF - market positioning

Set up in 1990
IPO 1997

Acquisitions lead to 19% market share in 2000-2006

NOW: Focus on retail distribution channels

Branded chain of pharmacies: 1,600 stores (13% market share)

Started up in 1990 as a family business, then operated under the name of Medicines, PGF embarked on an acquisition driven market expansion strategy aimed at comprehensive countrywide coverage in pharmaceutical wholesale distribution for retail pharmacies as well as hospitals. Following an injection of cash from a 1997 IPO, the company's revenues spring-boarded and by 2000 PGF had secured roughly a 19% share in the market, now worth nearly PLN 18bn (wholesale prices) and is expected to grow at the rate of ca. 3.7%, according to IMS Poland (4% to 5% based on the industry leader estimates). Focus of the company's strategy gradually shifted towards the retail distribution channels, which led to creation of the largest single branded chain of pharmacies numbering 1,600 drug stores (about 13% of the total number of pharmacies in Poland) including those operated independently and owned by PGF.

Market overview

Pharma market: PLN 18bn
2000-2006 CAGR 11.5%

Per capita spending: EUR 80...
...just 40% of Spain, Italy, UK

Worth PLN 18bn, the Polish pharmaceutical market expanded at our estimated CAGR of 11.5% (wholesale prices) in 2000-2006, driven primarily by increased availability of drugs and price convergence to the Western European level. Pharmaceutical consumption in Poland at EUR 80 per capita is just 40% of the levels in Spain, Italy or UK. Even so, the pace of pharmaceuticals market growth is likely to subside due to the government's stiffening of price controls on reimbursed drugs as well as increased use of less expensive generics, a phenomenon prevalent around the world as patents for innovative drugs expire.

Growth pace to subside due to stiffening price controls and generics use

Poland: sixth largest pharma market in EU

A gap to close – M&A imminent?

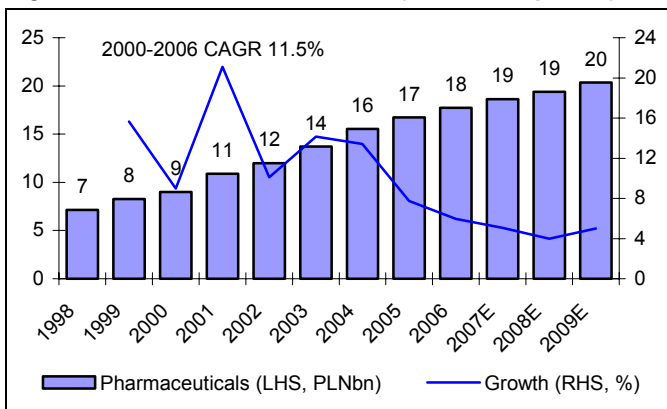
The consumption gap and the fact that Poland is the sixth largest pharmaceutical market in Europe makes it an attractive marketplace for pan-European wholesalers, leading to M&A activity at some point. PGF appears the most likely takeover target since it offers both a sizable wholesale market share and the largest branded pharmacy chain in Poland.

Market breakdown:
Sales to pharmacies: 90%
Hospitals: 10%

PGF rakes up 30% of the hospital delivery market – a growing niche

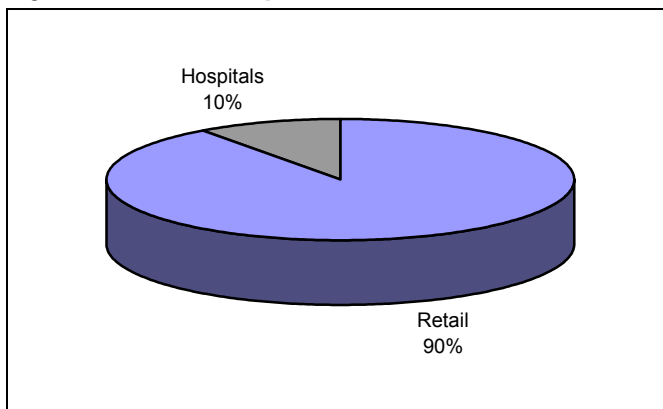
Retail pharmacies account for ca. 90% of the total wholesale market while hospitals make up the remaining 10%. Trading with hospitals involves inherent risks of delayed payments or defaults on receivables due to a persistently under-capitalised public healthcare system. For years this constituted an entry barrier used effectively by PGF to rake up over 30% of this niche market, which has grown at a 2004-2006 CAGR of 12% (outpacing the overall market growth of 9% during the same period).

Figure 1: **Pharmaceutical market (wholesale prices)**



Source: PharmaExpert, IMS Poland, CA IB

Figure 2: **Structure of pharmaceuticals sales**



Source: PharmaExpert, IMS Poland, CA IB

OTC

OTC drugs up 17.6% YoY outpacing the market on economic upturn

PGF upgrades stores and relocates OTC to self service area

sales up 29% YoY in selected testing sites

Over the counter (OTC) drug sales, most sensitive to changes in the economic cycle, account for about 28% of the pharmaceuticals market. Year to date (as of April 2007), their sales increased 17.6% YoY, outpacing the broad pharmaceutical market which grew at 9.7% YoY (and Rx sales up 8.3% YoY), according to PharmaExpert. Responding to these trends, PGF relocated OTC products to the self-service area of its drug stores. Feedback from pharmacies upgraded to the new floor arrangement is encouraging. 1Q 2007 sales in the selected sample of upgraded pharmacies increased on average 29% YoY (range from 9% to 69%) compared to "old" pharmacies' average sales drop of (2)% (ranging from a drop of (14%) to an increase in sales of 10%). OTC products' revenue share increased on average by 1% in the tested sites.

Rx

Rx medicine: ca. 60% of the market

Sensitive to regulatory changes ...key risk for the sector

Prescription medicine (Rx) remains the primary revenue pillar for distributors, accounting for about 60% of the total pharmaceutical market. Rx sales yield higher effective profit margins than other products but are also subject to regulatory pricing laws. The regulator sets the maximum prices and wholesale profit margins on refunded medicines. Changes to the pharmaceutical law pose the greatest risks in the wholesale pharmaceutical business.

PGF market position

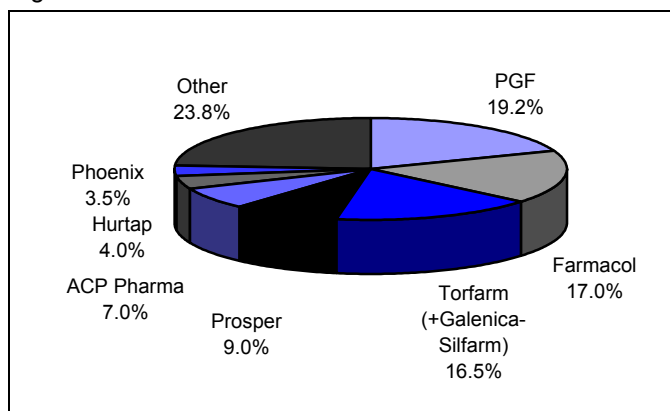
Consolidating market: number of distributors down to ca. 200 in 2006 from ca. 1000 in 1995

Number of drug stores nearly doubled

Six wholesalers comprise 75% of business

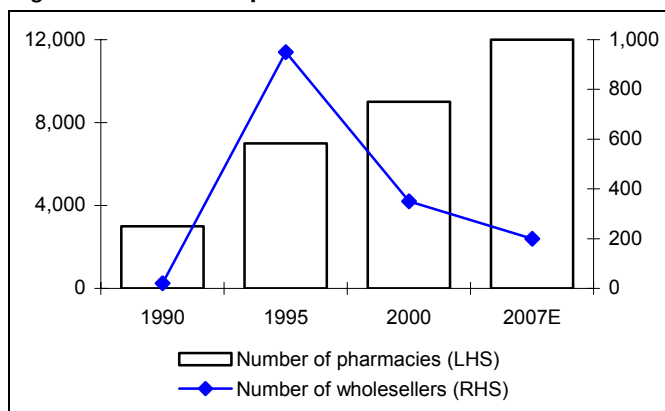
Six wholesalers dominated the pharmaceutical market, making up 75% of its total value, led by PGF with its market share of over 19% in 2006. Following an intensive consolidation phase, the number of distributors dropped to about 200 in 2006 from nearly 1,000 in the mid-1990s. The process continues to force distributors with no scale effect or no proprietary retail channels to either cope with narrowing wholesale margins or out of business. Since PGF is presently a much less active consolidator than historically in the wholesale segment, we expect PGF's share in the overall market to remain stable while the ongoing shift in its sales mix towards retail distribution channels (proprietary pharmacy chain) should provide an upside and subsequent profit margin expansion.

Figure 3: PGF's market share in wholesale distributor



Source: PharmaExpert, CA IB

Figure 4: Number of pharmacies vs. wholesalers



Source: PharmaExpert, CA IB

Retail pharma market:
2003-2006 CAGR of 6%...
but per store sales flat
as the number of new
pharmacies climbs to new highs
(currently ca. 12,000)

Increasing competition from
internet pharmacies
after law amendment

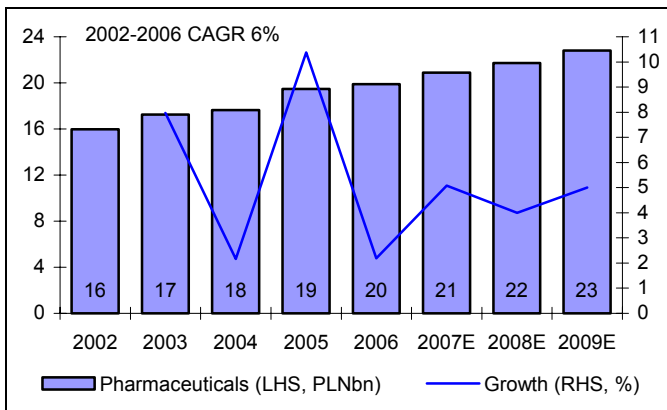
Pharmacists narrow down the
list to one or two suppliers
leaving acquisitions as the
primary tool of wholesale
market share expansion

Retail pharmacy segment

Competition in the retail pharmacy segment is intensifying as the number of pharmacies climbs to new highs. There are currently over 12 thousand pharmacies according to PharmaExpert (11,417 as of October 2006 according to IMS). Despite retail pharmaceuticals sales growth at a CAGR of 6% in 2003-2006, average revenues per pharmacy remained flat over the last five years. Competitive pressure is rising also from the online distribution channel after the passing of a pharmaceutical law amendment allowing online sales of non-prescription drugs. There are currently over 70 internet pharmacies in Poland but their popularity should rise since OTC drugs are on average 15-20% cheaper in online pharmacies.

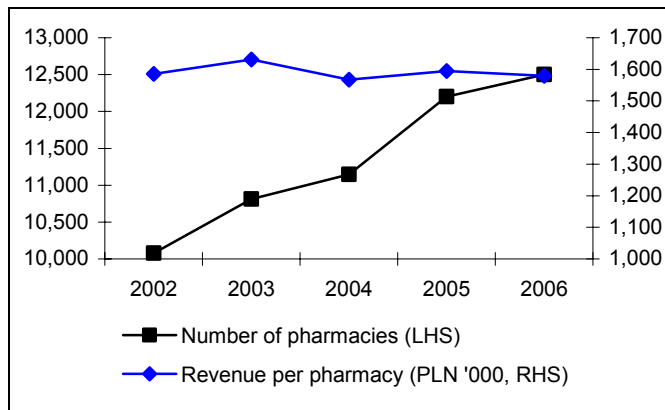
For wholesale distributors, winning new clients has become more difficult since high pricing pressure at the retail level translated into their cooperation, which narrowed them down to one or two wholesalers at the time in order to maximise volume discounts. In a questionnaire discussed during the Annual Summit of Wholesalers (October 2006), 80% of pharmacists declared that they purchase bulk inventory from one or two suppliers while 92% of them have not changed their supplier in the last two years. Closer cooperation with selected distributors restructured the market makes it safer from the receivables collection perspective (an Achilles' hill of the industry in the past) but has also made it more difficult to gain access to or become the primary provider for a new client. This leaves acquisitions as the primary tool of expansion of wholesale market share.

Figure 5: Pharmaceutical market (retail prices)



Source: PharmaExpert, CA IB

Figure 6: Number of pharmacies vs. per store sales



Source: PharmaExpert, CA IB

Market monitoring firms expect
2007E growth at 3-4% YoY
Wholesalers expect 5% YoY

Regulatory changes could alter
the dynamics

Market trends and drivers

According to the market monitoring firms, IMS Poland and PharmaExpert, the pharmaceuticals market in Poland is expected to grow at 3% - 4% in 2007. Coming after 9.7% YoY growth in April (YTD), this seems like a conservative forecast. Wholesalers expect the market to grow at about 5% YoY in 2007 but agree that proposed changes to pharmaceutical laws (introduction of fixed margins across all distribution channels) could change the market scene considerably towards the year end.

In the mid to long term horizon, key market growth factors include:

Positive:

- 1) (+) growing consumption of drugs as an increasing number of people are treated for chronic illnesses
- 2) (+) increased OTC drugs purchases as disposable income rises

Neutral:

- 3) (+/-) introduction of fixed profit margins across all distribution channels; it will inevitably increase prices of controlled (reimbursed) pharmaceuticals, but on the other hand may decrease their sales volume

Negative:

- 4) (-) 'generification' – increased use of generics replacing more expensive innovative drugs as their patent protections expire
- 5) (-) increasingly stringent regulatory control and record keeping of prescriptions and pharmaceutical usage (recently introduced requirement to place an ID number on prescriptions) aimed at eradicating abuses and fraud related to reimbursed medications

Key risks

Regulatory risks – key to consider

Regulatory changes constitute, in our view, the primary risk factor in the wholesale and retail pharmaceutical business. Recently the government proposed an amendment to the pharmaceutical law which would effectively ban the creation of new pharmacy chains. While the restriction itself seems to interfere with the scope of the antitrust office, the parameters of store concentration levels, which would necessitate their sell-off by the pharmacy chain operator, seem to have no valid justification and we expect the amendment to be substantially altered before parliamentary approval is granted.

Effective ban on new pharmacy chain creation

Government proposes an effective ban on creation of new pharmacy chains

The new law proposal introduces mandatory license suspension for wholesalers and retailers whose chains include the number of pharmacies that exceed 1% of the total number of pharmacies in each particular state (voivoidship). The companies would have five years (through 1 September 2012) to comply with the new regulations. Once the law becomes effective, every new application for the opening of a new pharmacy or wholesale operations has to be accompanied by a detailed description of the capital group structure to prevent the potential mix of the retail and wholesale operations. The new law awaits parliamentary approval.

Value enhancement to PGF's existing retail chain

While effective ban on new pharmacy chains makes further vertical integration (and subsequent margin expansion) virtually impossible, it also enhances the value of the existing retail chains, including PGF's largest-in-Poland drug store chain under the DoZ (an abbreviation for 'I care for my health') brand.

Introduction of fixed profit margins and regulated prices

Introduction of fixed profit margins and regulated prices

The aforementioned proposal for a new pharmaceutical law introduces stringent control over statutory profit margins realised on prescription medicines. It includes new definitions of regulated prices and profit margins, which will be fixed at the level of producers, wholesalers and retailers (i.e. pharmacies).

Fixed margins and regulated prices allow for no rebates to pharmacies but also no volume discounts to wholesalers on reimbursed medicines which comprise about 50% of the total market. Higher retail prices on reimbursed medicines (PharmaExpert estimates by 4-5%) should to an extent offset these unfavourable changes. Wholesalers agree that while they can handle the changes neutralising their impact on business, the new regulations in themselves introduce a very artificial price setting mechanism, the consequences of which would be quite difficult to define at this point.

Wholesale profit margin cut to 8.68% (by 0.23 pp)

**Wholesale profit margin cut
 by 0.23pp
 Minor short-term downside**

The government accepted a wholesale profit margin cut to 8.68% (down 0.23pp from 8.91%) on regulated, reimbursed pharmaceuticals. The new statutory wholesale profit margin reduction should be effective as of September 2007, with an impact in 4Q 2007.

**Wholesellers say:
 "been there, done that"**

Just like with the more pronounced margins cuts in the past, the impact of this reduction should be offset by the volume discounts over the long run and wholesalers do not expect a dent in their profitability since the reduction is quite minor and affects only a part (less than a half in most cases) of their sales portfolio. The wholesalers operating on already low profit margins with no retail sales channels to absorb the reduction may feel its impact, though in the short term.

Operating highlights

PGF valued for market share in wholesale... under-appreciated retail

PGF has been valued by investors for its market share, which at 19% is the largest in Poland in wholesale distribution, and for its economies of scale, but the company's slowly but consequently built retail sales operations remain under-appreciated, in our view. The business of the largest Polish pharmaceutical wholesaler includes efficiency reserves in the restructured retail pharmacy chain including both proprietary stores and stores operated independently under the common brand DoZ (an abbreviation of 'I care for my health'). After years of restructuring and rebranding, this segment appears ready to be put online, which should bolster the distributor's profit margins.

"DoZ" branded pharmacy chain

The best of two worlds? Wholesale volume and vertical integration of retail margins

Under the umbrella brand of "DoZ", PGF gathered over 1,600 drug stores including proprietary pharmacies that often required an intense restructuring. PGF's implemented loyalty program for retail clients binds the pharmacies closer to one distributor (by rewarding pharmacists for increasing their share of drug purchases in one place) and provides a platform for provision of customer-tailored services including targeted marketing of products or offering branded credit cards. In exchange for displaying the logo of "DoZ", pharmacies participate in the promotional campaigns of pharmaceutical producers, discount programs for their clients, and receive healthcare newsletters with articles to distribute among clients.

With the restructuring process drawing to a conclusion in PGF's proprietary pharmacies, the DoZ branded chain should provide multiple benefits not accessible to pure wholesale distributors. Those include:

- 1) profit margin improvement due to vertical integration (in proprietary pharmacies)
- 2) lower or no receivable risks
- 3) increased rotation of capital and better allocation of resources
- 4) additional services for producers including product marketing support, one-stop facilitation of promotions, and in the future direct advertising or home drug delivery for clients involved in the program
- 5) in the remote future: with the largest number of pharmacies associated under one brand, PGF should be the first partner in line in talks with private insurance companies reimbursing drug costs for their clients (once the healthcare system becomes partially privatised)

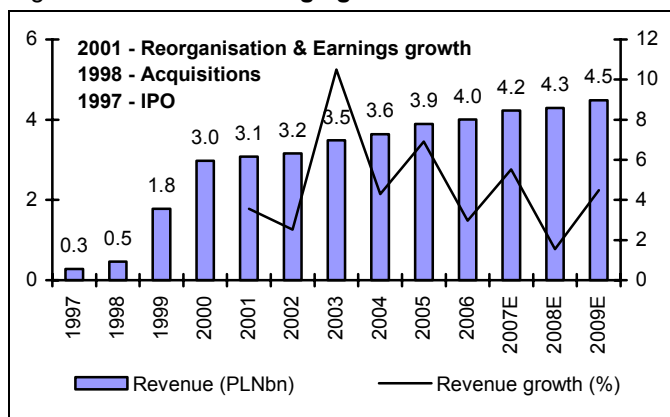
Revenues climbing in retail sales segment

Sales 2003-2006 CAGR 6%

In 2006 sales growth driven by retail sales (up 26% YoY)

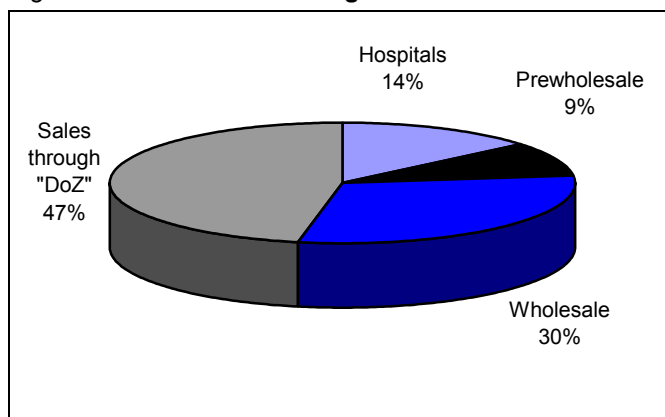
Over the last four years PGF's revenues increased at a 2003-2006 CAGR of 6% driven primarily by dynamically growing sales in its retail distribution segment, which have yet to translate into profits. In 2006 nearly half of PGF's sales were realised through the branded pharmacy chain DoZ, which includes sales through proprietary pharmacies. They were up 26% YoY in 2006 and accounted for 15% of the company's revenues but still a negligible part of operating profits last year. Sales to independent, non-DoZ branded pharmacies made up about 30% of the company's top line.

Figure 7: Time for earnings growth focus



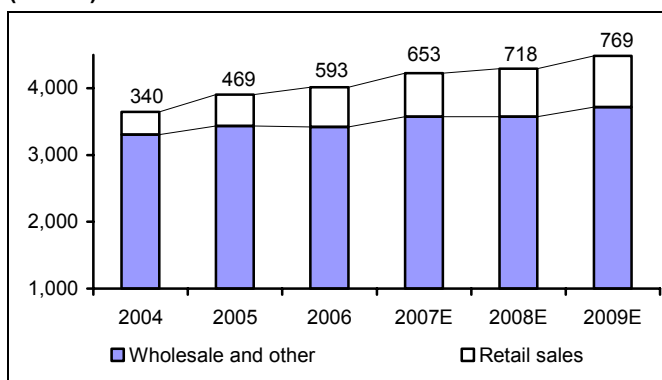
Source: PGF, CA IB

Figure 8: Bulk of sales through PGF's "virtual" chain



Source: PGF, CA IB

Figure 9: Revenue climbs in retail sales segment (PLNm)



Source: PGF, CA IB

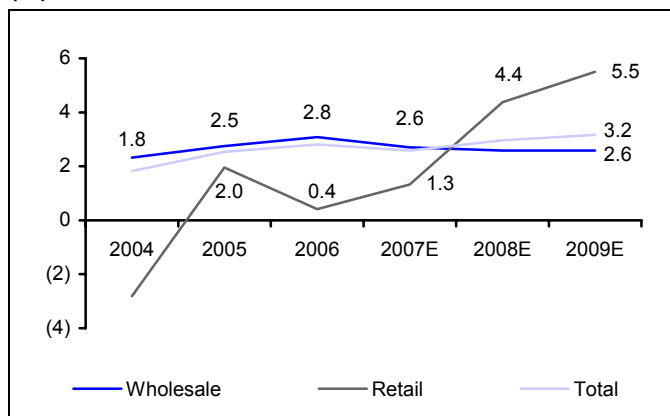
Focus on profitability

Focus on profitability... now boosted by the retail sales segment

The company's focus on profitability has led to earnings 2003-2006 CAGR of 29%, an impressive result, which however still fails to reflect the impact of the now reorganized, PGF proprietary pharmacies operated under the DoZ brand. Based on our pharmacy model estimates, which include the average drug store's gross profit margin at twice the level of the wholesaler (after the PharmaExpert data), we expect the contribution of the retail business to boost the company's operating profit margins, driving our estimated earnings at a CAGR of 15% through 2009E.

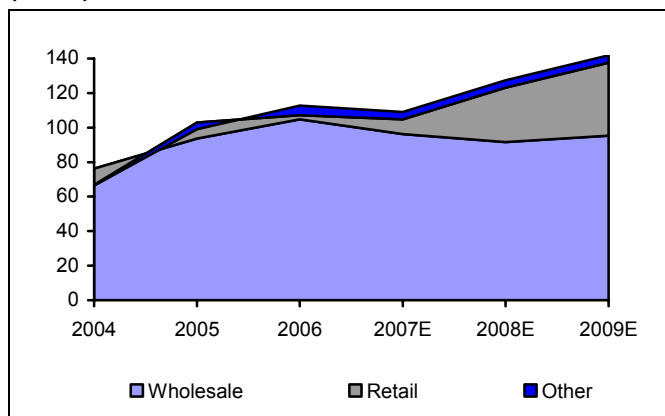
Although it may not seem as much, in the volume-driven pharmaceutical distribution sector every 0.1% margin improvement translates into PLN 4m of extra profit, in our case translating into EBITDA accretion of PLN 24m over the three-year period (22% of the company's 2006 EBITDA).

Figure 10: EBITDA margings by distribution channel (%)



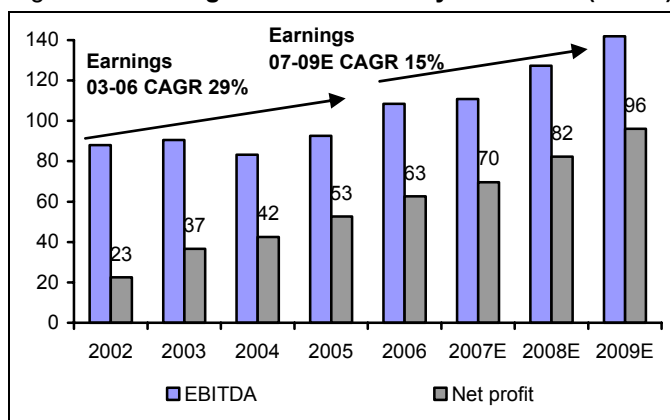
Source: PGF, CA IB

Figure 11: EBITDA contribution by business segment (PLNm)



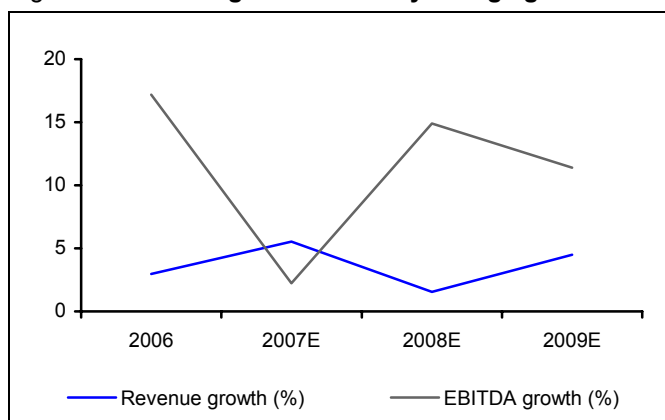
Source: PGF, CA IB

Figure 12: Earnings CAGR boosted by retail sales (PLNm)



Source: PGF, CA IB

Figure 13: EBITDA growth driven by changing sales mix



Source: PGF, CA IB

Forecasts

Earnings 2007-2009E CAGR 15% driven by retail sales

We estimate that PGF earnings 2007-2009E CAGR should reach 15% driven primarily by the boost from the company's retail pharmacy sales segment. Our base case includes revenue growth at a conservative CAGR of 3.8%, taking into account a very uncertain market impact of the proposed changes to the pharmaceutical law.

Our 2007 forecast accounts for sale lease-back impact...

In our 2007 estimates we have included the impact of the sale lease back operation on the company's real estate, which resulted in an extra PLN 7.6m in leasing costs (lowering our EBITDA profit) but freed substantial cash resources (ca. PLN 100m) for acquisitions or other investments.

...and is in line with management's guidance

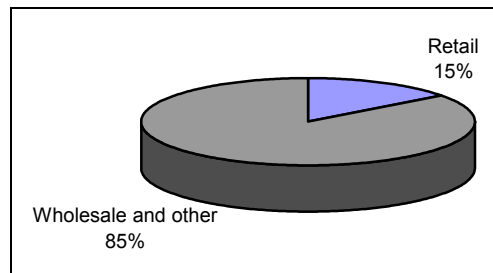
Our 2007 net profit estimates are in line with the management's implied guidance of 'double-digit' earnings growth in 2007.

Table 1: Financial forecasts

PLNm	2006	2007E	2008E	2009E
Revenues	4,006	4,227	4,293	4,485
- retail sales	593	653	718	769
EBITDA	108	111	127	142
- retail sales	2	9	31	42
Net profit	63	70	82	96
Sales growth (%)	3.0	5.5	1.5	4.5
EBITDA margin (%)	2.7	2.6	3.0	3.2
Net profit margin (%)	1.6	1.6	1.9	2.1

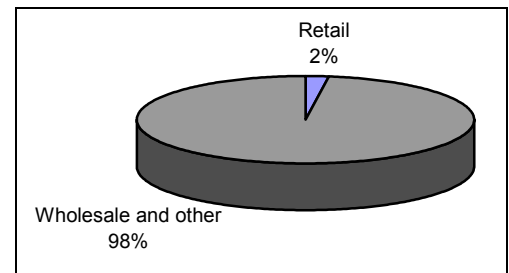
Source: PGF, CA IB

Figure 14: Revenue split (value) 2006



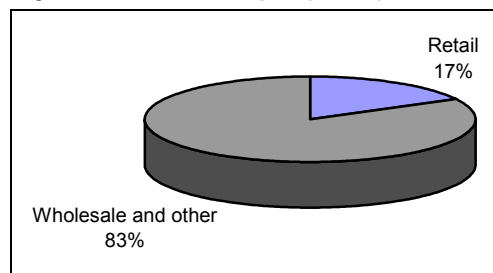
Source: PGF, CA IB

Figure 15: EBITDA split 2006



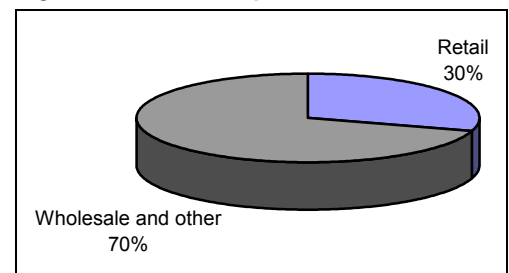
Source: PGF, CA IB

Figure 16: Revenue split (value) 2009E



Source: PGF, CA IB

Figure 17: EBITDA split 2009E



Source: PGF, CA IB

Valuation

DCF

Based on our DCF model, we estimate PGF's 12-month price target at PLN 125 per share. Our primary assumptions include WACC at 7.4% (Risk free at 5.25%, equity risk premium at 4.5%, leveraged beta of 1.0x) and terminal growth rate at 1.7%.

Table 2: Discounted cash flow valuation

PLNm	2006	2007	2008	2009	2010	2011
Revenues	4,006	4,227	4,293	4,485	4,523	4,564
EBIT	87	92	108	122	124	125
Tax	17	18	21	23	23	24
NOPAT	71	73	87	98	100	101
(+) Depreciation	21	19	19	20	20	21
(-) Investments	(27)	24	27	28	29	29
(-) Change in NWC	10	6	3	9	2	2
FCF	109	61	76	81	90	91
PV (FCF)		57	66	65	75	71
Weighted Average Cost of Capital		(%)				
Risk free rate		5.3				
Debt premium		1.0				
Tax		19.0				
Cost of debt (after tax shield)		5.1				
Equity risk premium		4.5				
Unleveraged beta (x)		0.6				
Leveraged beta (x)		1.0				
Cost of capital		9.9				
Debt/capital (x)		0.5				
Debt/equity (x)		1.0				
WACC		7.4				
Terminal growth rate		1.7				
Valuation						
PV DCF (PLNm)		1,596				
Residual value		1,262				
Net debt (cash)		190				
Month		6				
Fair equity value		1,476				
Shares (m)		13.0				
Fair value		113				
12m price target (PLN)		125				

Source: PGF, CA IB

Comparable valuation

PGF is trading at our estimated 2008E and 2009E P/E of 16x and 14x, with 7% and 13% discount to the European peers and with 12% and 6% premium to local peers. We find the premium well deserved given the leading market share, its wholesale business efficiency and the largest retail pharmacy chain, which makes PGF a first in line acquisition target for a potential pan-European partner.

Table 3: EU peer group comparable valuation

Company	Ticker	Price	Currency	MCAP (EURm)	P/E (x)			EV/EBITDA (x)		
					2007E	2008E	2009E	2007E	2008E	2009E
Celesio AG	CLS1 GR	48.8	EUR	8,308	17.7	15.7	14.0	11.6	10.6	9.6
Andreae-Noris Zahn AG	ANZ GR	37.1	EUR	396	10.9	14.4	13.1	10.8	9.4	9.1
Sanacorp Pharmahandel	SNC3 GR	32.5	EUR	266	13.9	12.0	11.3	9.6	8.8	8.6
Alliance Boots PLC	AB/ LN	11.2	GBP	16,051	24.8	22.0	19.7	13.3	12.2	11.6
United Drug Plc	UDG ID	4.1	EUR	911	18.4	16.3	14.7	13.5	12.1	11.3
Meda AB	MEDAA SS	119.5	SEK	2,781	22.7	22.2	22.9	12.5	11.1	10.5
Galenica Holding AG	GALN SW	425.0	CHF	1,680	24.0	20.1	17.0	16.8	14.6	12.7
OPG Groep NV	OPG NA	26.7	EUR	1,555	17.5	16.0	15.6	10.7	9.8	9.5
Average					18.7	17.3	16.0	12.3	11.1	10.3
PGF	PGF PW	103.4	PLN	1,329	18.9	16.2	13.9	13.2	11.1	9.5
Discount (%)					1	(7)	(13)	7	(0)	(8)

Source: Bloomberg, CA IB

Table 4: Polish peer group comparable valuation

	Price	MCAP (PLNm)	2007E	P/E (x)			EV/EBITDA (x)		
				2008E	2009E	2007E	2008E	2009E	
Farmacol	47.9	1,121	15.3	14.1	13.2	11.1	10.4	9.8	
Prosper	24.4	168	13.9	12.2	11.6	8.5	8.5	8.3	
Torfarm	92.2	364	23.6	17.1	14.4	14.7	11.0	9.7	
Average			17.6	14.5	13.1	11.5	10.0	9.2	
PGF	103.4	1,328.6	18.9	16.2	13.9	13.2	11.1	9.5	
Discount (%)			7	12	6	15	11	3	

Source: Bloomberg, CA IB

Financials – PGF

Table 5: Profit and loss

PLNm	2005	2006	2007E	2008E	2009E
Net revenue	3,891	4,006	4,227	4,293	4,485
Gross profit	373	421	448	472	500
SG&A	(310)	(346)	(359)	(364)	(378)
Other operating, net	13	12	3	0	0
EBITDA	93	108	111	127	142
Depreciation	(17)	(21)	(19)	(19)	(20)
EBIT	76	87	92	108	122
Net financials	(3)	(6)	(5)	(5)	(2)
Pre-tax profit	72	81	87	103	120
Tax	(18)	(18)	(17)	(20)	(23)
Minority interest	(2)	(0)	(0)	(0)	(0)
Net profit	53	63	70	82	96

Source: PGF, CA IB

Table 6: Cash flow

PLNm	2005	2006	2007E	2008E	2009E
Net profit	53	63	70	82	96
Depreciation	17	21	19	19	20
Cash earnings	70	84	88	101	116
Change in WC	5	(10)	(6)	(3)	(9)
Operations	74	74	82	98	107
Investments	(55)	27	(24)	(27)	(28)
Marketable securities	24	(3)	56	61	73
Financing	4	(104)	(2)	(10)	(6)
Dividends	(27)	(30)	(31)	(32)	(35)
Change in cash	24	(3)	56	61	73

Source: PGF, CA IB

Table 7: Balance sheet

PLNm	2005	2006	2007E	2008E	2009E
Fixed assets	470	419	480	549	630
Net working capital	166	176	183	186	195
Capital employed	637	595	663	735	825
Shareholders equity	257	291	354	423	506
Debt	379	304	309	312	320
Marketable securities	65	62	118	179	252
Total assets	1,445	1,488	1,608	1,694	1,826

Source: PGF, CA IB

Table 8: Ratios

PLNm	2005	2006	2007E	2008E	2009E
EBITDA margin (%)	2.4	2.7	2.6	3.0	3.2
EBIT margin (%)	1.9	2.2	2.2	2.5	2.7
Net margin (%)	1.4	1.6	1.6	1.9	2.1
Net debt/equity (x)	1.1	0.7	0.4	0.2	0.0
Current ratio (x)	1.3	1.3	1.3	1.4	1.4
Sales/receivables (x)	9.0	8.6	8.6	8.6	8.6
COGS/payables (x)	4.3	4.0	4.0	4.0	4.0
ROE (%)	20.4	21.5	19.7	19.4	19.0
ROIC (%)	11.1	12.3	13.9	16.0	17.7
BVPS	20.7	22.9	27.5	32.8	38.9

Source: PGF, CA IB

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	Buy	Hold	Sell	Coverage In Transition	Restricted
Count	42	59	20	5	2
% of total	32.8	46.1	15.6	3.9	1.6

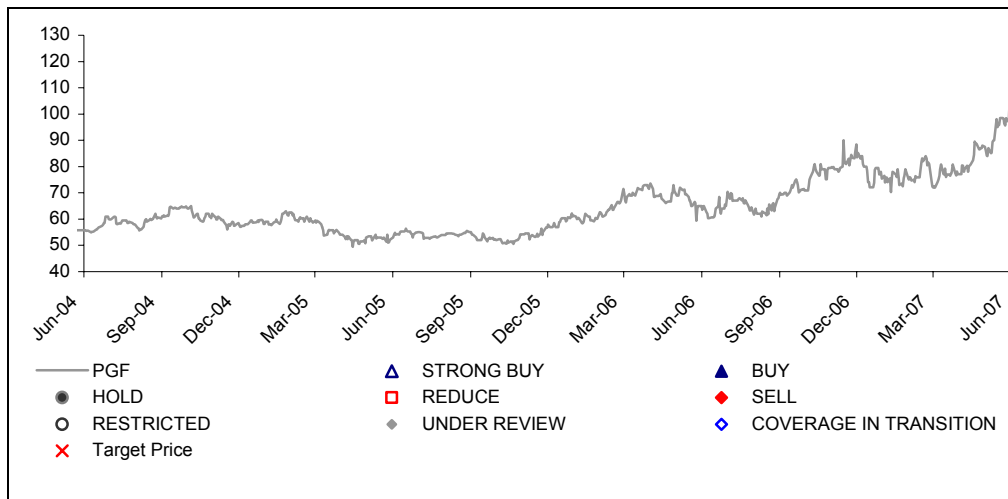
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% of total	33.3	33.3	11.1	11.1	11.1

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History of CA IB's rating of PGF



Source: Datastream, CA IB

Other regulatory disclosures

	1	2	3	4	5	6
PGF	No	No	No	No	No	No

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