# CHAPTER VI MANAGEMENT'S DISCUSSION AND ANALYSIS

## 1. Management of Financial Resources

The management of the financial resources by Eurocash was assessed on the basis of the Company's financial statements for 2003 and for the period from January 1st 2004 to September 30th 2004. Because of the fact that the Company started commercial operations on October 1st 2002, there is no comparable financial data for the whole year of 2002, which makes it difficult to analyse the management of financial resources by the Company.

The analysis was carried out using the profitability, liquidity and debt ratios, as well as ratios describing the Company's working capital structure.

### *1.1. Profitability Analysis*

The table below presents an analysis of the Company's profitability, carried out based on the key profitability ratios.

Table VI.1. Eurocash profitability ratios

| No. | Jan–Sep 2004 | Jan–Sep 2003 | Jan-Jul 2004 | 2003 | 2002** |
|---|---|---|---|---|---|
| 1. Sales revenue (PLN '000) | 1,195,982 | 1,019,463 | 907,615 | 1,374,545 | 274,560 |
| 2. EBITDA (PLN '000) | 35,247 | 11,360 | 24,340 | 19,284 | (10,129) |
| 3. Operating profit (loss) (PLN '000) | 21,527 | 1,418 | 14,820 | 5,879 | (13,575) |
| 4. Net profit / loss (PLN '000) | 17,141 | 950 | 11,496 | 4,100 | (10,402) |
| 5. EBITDA margin (2/1) | 2.9% | 1.1% | 2.7% | 1.4% | (3.7%) |
| 6. Operating margin (3/1) | 1.8% | 0.1% | 1.6% | 0.4% | (4.9%) |
| 7. Net sales margin (4/1) | 1.4% | 0.1% | 1.3%* | 0.3% | (3.8%) |
| 8. Return on assets (ROA) (%) | 6.2% | 0.4% | 5.0%* | 1.1% | - |
| 9. Return on equity (ROE) (%) | 16.5% | 1.1% | 14.8%* | 3.5% | - |

** Based on annualised net profit (net profit for the period extrapolated over 12 months).*

*** The Company has conducted business activities since October 2002.*

*No data for 2001 is disclosed in the table as the Company did not conduct any business activity in the year.*

*Source: The Issuer.*

*Gross sales margin – sales revenue less the value of goods and materials sold.*

*Margins – ratios of relevant profits (profit on sales, EBITDA, operating profit, net profit) to net sales revenue.*

*Return on assets (ROA) – ratio of net profit for a given period to the value of assets as at the end of such period.*

*Return on equity (ROE) – ratio of net profit for a given period to the total shareholders' equity as at the end of such period.*

#### *1.1.1. Sales Revenue*

Net sales revenue generated by Eurocash in the period of nine months ended on September 30th 2004 stood at PLN 1,195,982 thousand, which means a 17.3% increase in comparison with the same period in 2003. Revenue on sales of goods and materials accounts for nearly 94% of the revenue. The balance represents the revenue on sales of products, which comprises mainly bonuses received from suppliers for generating a target sales volume in a given period.

The growth in Eurocash's revenue is attributable to such factors as the optimisation of the Company's product range and pricing policy, which led to an increase in the average turnover generated by each customer making purchases in the Discounts Cash & Carry chain. In January–September 2004 the customer's average monthly turnover grew by over 20% on the figures posted in the analogous period of 2003. A steady rise was also noted in the sales to the „abc" stores. In the period January-September 2004, they increased by 23.5% year on year. Moreover, in the same period, their percentage share in total sales revenue rose by 1.7 percentage points (to 33.5%) as compared with the analogous period of 2003. In the opinion of the Management Board, the rise was attributable to the restructuring of the "abc" chain.

The opening of three new Discounts Cash & Carry in 2004 also contributed to the increase in sales revenue. In the period from their opening (July - August 2004) to September 2004, the newly-opened facilities generated aggregate sales revenue totalling PLN 3.1m.

### *1.1.2. Costs*

***Selling Costs***

In January–September 2004, the selling costs amounted to PLN 81,810 thousand (6.8% of sales), in comparison with PLN 81,791 thousand (8.0% of sales) in the same period in 2003. The selling costs comprised:

- costs related to Discounts Cash & Carry operated by Eurocash (70% of selling costs);
- costs related to Discounts Cash & Carry operated under agency agreements (14% of selling costs);
- costs of operations of distributions centres (16% of selling costs).

The key cost items related to the Discounts Cash & Carry operated by Eurocash include:

- personnel costs, including: remuneration, social security contributions and other benefits;
- rental costs, including mainly the lease of premises for warehouse stores;
- transport costs;
- depreciation and amortisation; and
- other operating expenses, including: utilities (water, electricity, and gas), contracted services and other operating expenses.

In the case of Discounts Cash & Carry operated under agency agreements, the main Eurocash cost item was the agents' commission fees. The agents cover, at their expense, the personnel costs, costs of lease of premises for warehouse stores and other costs related to the store maintenance. In addition, Eurocash covers the costs of transport, depreciation and amortisation, as well as contracted services.

The costs related to the operations of distribution centres comprise mainly the costs of lease and maintenance of warehouse premises, personnel costs and depreciation and amortisation.

In the period under discussion, the growth of sales was to a large extent driven by higher turnover at the existing Discounts Cash & Carry , which did not increase the costs related to the operations of Discounts Cash & Carry and the distributions centres.

***General and Administrative Expenses***

In January–September 2004, general and administrative expenses amounted to PLN 30,686 thousand (2.6% of sales), in comparison with PLN 18,321 thousand (1.8% of sales) in the same period in 2003. General and administrative expenses comprise mainly expenses related to the operations of the Company's head office. The growth in costs in this period was mainly attributable to increased personnel and advertising costs, as well as higher charges attributable to depreciation and leasing of computer hardware. The rise in personnel costs followed partly from Eurocash establishing its own IT department, in connection with the implementation of a new IT system which replaced an old one, temporarily used jointly with Jeronimo Martins Dystrybucja.

***Other Operating Expenses***

In January–September 2004, other operating expenses amounted to PLN 12,079 thousand (1.0% of sales), relative to PLN 12,473 thousand (1.2% of sales) in the same period in 2003. Other operating expenses in the period from January to September 2004 comprised mainly payments under the licence agreement with Politra on the use of know-how (described in Section 8 of Chapter V) and warehouse losses.

Payments under the licence agreement with Politra amounted to PLN 6,957 thousand in January–August 2004. Following the termination of the agreement, Eurocash made a one-off repayment of future liabilities under this agreement, and the acquired know-how was disclosed in the balance sheet under intangible fixed assets. In September 2004, the Company ceased to incur the costs of licence fees for the know-how and began to amortise the acquired intangible fixed assets (to be written off over 60 months on a straight-line basis). The monthly amount of amortisation is PLN 905.4 thousand and it is disclosed under general and administrative expenses.

Warehouse losses are related to the nature of Eurocash operations. Minimising them is of key importance to the Company. As a result of strict operational control, the warehouse loss ratio for January–September 2004 stood at 0.3% of sales.

***Operating Profit***

In 2003, the main factors driving the increase in profitability of the Company's operations was improvement in the efficiency of its operations, following the rationalisation-oriented steps taken in this area by the new owner after the buy-out of the Company by the current President of its Management Board. This included introduction of clearly defined incentives for the personnel, revision of the terms on which trade credits are granted, extension of the "abc" shops chain, restructuring of the logistics system, implementation of a new pricing policy, and launch of brands available only in the Eurocash chain.

In January - September 2004, the Company continued to optimise operating expenses, which brought about a further increase in the Company's profitability. The operating margin for this period reached 1.8% in comparison with 0.4% for the whole of 2003.

***Net Profit***

In January - September 2004, Eurocash's net profit amounted to PLN 17.1m, whereas in 2003 the net profit stood at PLN 4.1m. This increase was possible due to the restructuring of the Company's operations in 2003, continued also in 2004, as well as the increased sales. As the fixed portion of the operating expenses remained stable the growth rate of the net profit was larger than the growth rate of sales.

Net profit for January–September 2004 was affected by repayment of interest under a loan advanced to Eurocash by Jeronimo Martins Dystrybucja. The interest payment in this period amounted to PLN 3,095 thousand. On September 14th 2004, Eurocash repaid all of its liabilities under the loan, therefore they will not have a bearing on net profit in the years to come.

### *1.2. Liquidity*

The liquidity of the Eurocash operations has been evaluated using the ratios shown in the table below.

Table VI.2. Liquidity ratios

| | Sep 30 2004 | Sep 30 2003 | Dec 31 2003 | Dec 31 2002* |
|---|---|---|---|---|
| Current ratio | 0.85 | 1.02 | 1.15 | 0.96 |
| Quick ratio | 0.34 | 0.57 | 0.67 | 0.45 |
| Cash ratio | 0.19 | 0.33 | 0.50 | 0.26 |

** The Company has conducted business activities since October 2002.*

*No data for 2001 is disclosed in the table as the Company did not conduct any business activity in the year.*

*Source: Eurocash.*

*Current ratio – ratio of current assets to short-term liabilities as at the end of a given period; it describes a company's ability to discharge its short-term liabilities using its current assets.*

*Quick ratio – ratio of current assets, net of stocks, to short-term liabilities as at the end of a given period; it describes a company's ability to collect in a short time funds for covering maturing liabilities.*

*Cash ratio – ratio of cash to short-term liabilities as at the end of a given period; it describes a company's ability to cover immediately payable liabilities using the funds at its disposal.*

The levels of the liquidity ratios reflect the nature of the Company's activity. On the one hand the Company maintains a high level of short-term liabilities, mainly due to the trade credit received from its suppliers, and on the other hand the wholesale business conducted by the Company requires it to maintain a certain minimum level of stocks ensuring uninterrupted supplies. It must be emphasised, however, that most of the wholesale is conducted in the cash & carry system, with limited use of the trade credit, which translates into relatively high cash ratios.

Eurocash employs a conservative policy with respect to granting trade credit: as a rule trade credit may be granted only to proved customers and in each case commitment levels are subject to strict monitoring and control at the level of each customer. Eurocash's computer system enables a daily analysis of the trade credit balances and allows the Company to quickly react in the event of any problems with the customers' solvency. The decrease in liquidity ratios in January-September 2004 in relation to with the figures as at the end of 2003 was caused mainly by an outflow of cash, resulting from the repayment of future liabilities under the licence agreement with Politra and the repayment of a loan to JMD.

### *1.3. Working Capital and Turnover Ratios*

Table VI.3. Current assets (PLN '000)

| No. | | Sep 30 2004 | Sep 30 2003 | Dec 31 2003 | Dec 31 2002* |
|---|---|---|---|---|---|
| **1.** | **Adjusted current assets (2+3-4)** | **101,816** | **70,134** | **31,284** | **73,323** |
| 2. | Stocks | 110,931 | 86,569 | 99,474 | 84,933 |
| 3. | Accounts receivable | 31,423 | 47,032 | 35,543 | 31,855 |
| 4. | Cash and marketable securities | 40,538 | 63,468 | 103,733 | 43,464 |
| **5.** | **Current liabilities (6-7)** | **214,165** | **192,311** | **207,856** | **167,362** |
| 6. | Short-term liabilities | 214,165 | 192,311 | 211,456 | 167,362 |
| 7. | Short-term loans | 0 | 0 | 3,600 | 0 |
| **8.** | **Working capital (2+3-6)** | **(71,811)** | **(58,710)** | **(76,439)** | **(50,574)** |
| **9.** | **Working capital needs (1-5)** | **(112,349)** | **(122,177)** | **(176,572)** | **(94,038)** |
| **10.** | **Net cash (4-7)** | **40,538** | **63,468** | **100,133** | **43,464** |
| **11.** | **Share of own funds in financing of working capital (8/(2+3))** | **(50.45%)** | **(43.94%)** | **(56.6%)** | **(43.3%)** |

** The Company has conducted business activities since October 2002.*

*No data for 2001 is disclosed in the table as the Company did not conduct any business activity in the year.*

*Source: Eurocash.*

In the period under discussion, the Issuer's current assets were financed with external capital. Such financing structure reflects the nature of Eurocash's operations, involving the use of trade credit. Throughout the period under discussion, the value of working capital remained negative, which is in particular attributable to the favourable relation between the time of receiving cash for the goods sold (the majority of sales is settled in cash), and the average payment period.

These factors, together with the short stock cycle, contribute to the negative cash conversion cycle. The table below sets forth the Issuer's turnover ratios.

Table VI.4. Turnover ratios for main items of the working capital (in days)

| No. | | Jan–Sep 2004 | Jan–Sep 2003 | 2003 | 2002* |
|---|---|---|---|---|---|
| 1. | Stock cycle | 25.3 | 23.2 | 26.4 | 28.2 |
| 2. | Average collection period | 7.2 | 12.6 | 9.4 | 10.6 |
| 3. | Average payment period | 55.7 | 57.9 | 62.3 | 61.6 |
| 4. | Operating cycle (1+2) | 32.5 | 35.8 | 35.9 | 38.7 |
| 5. | Cash conversion cycle (4-3) | (23.2) | (22.2) | (26.4) | (22.9) |

** The Company has conducted business activities since October 2002.*

*No data for 2001 is disclosed in the table as the Company did not conduct any business activity in the year.*

*Source: Eurocash.*

*Stock cycle – the ratio of balance of stocks at end of period to net revenue for period, multiplied by the number of days in the period.*

*Average collection period – the ratio of balance of accounts receivable at end of period to net revenue for period, multiplied by the number of days in the period; average collection period reveals the average time (in days) of payment by trade debtors.*

*Average payment period – the ratio of balance of liabilities at end of period to operating expenses for period, multiplied by the number of days in the period; average payment period reveals the average time (in days) of payment to trade creditors.*

*Operating cycle – the sum of stock cycle and average collection period.*

*Cash conversion cycle – the difference between operating cycle and average payment period; it describes the company's indebtedness.*

### *1.4. Issuer's Indebtedness*

The table below sets forth principal debt ratios for Eurocash.

Table VI.5. Financing structure

| | Sep 30 2004 | Sep 30 2003 | Dec 31 2003 | Dec 31 2002* |
|---|---|---|---|---|
| Debt to assets ratio | 0.62 | 0.65 | 0.68 | 0.62 |
| Debt to equity ratio | 1.65 | 1.82 | 2.13 | 1.63 |
| Absorption of assets by equity | 0.38 | 0.35 | 0.32 | 0.38 |
| Long-term debt to assets ratio | 0.01 | 0.00 | 0.07 | 0.00 |

** The Company has conducted business activities since October 2002.*

*No data for 2001 is disclosed in the table as the Company did not conduct any business activity in the year.*

*Source: Eurocash.*

*Debt to assets ratio – ratio of total liabilities to total assets; it reveals the share of external sources of financing in the financing of the company's operations.*

*Debt to equity ratio – the ratio of total liabilities to shareholders' equity.*

*Absorption of assets by equity – the ratio of shareholders' equity to total assets; it reveals the share of internally generated funds in the financing of the company's operations.*

*Long-term debt to assets ratio – the ratio of long-term liabilities to total assets; it reveals the share of long-term liabilities in the financing of the company's operations.*

In the period under discussion, the Issuer recorded debt to assets ratio in the range of 62%-68%. However, the majority of the Issuer's liabilities are short-term trade liabilities, reflecting the nature of the Issuer's operations and financing of working capital.

## 2. Factors and Extraordinary Events Affecting the Results of Eurocash Business Activities

***Commencement of Activities***

Given that the Company started its operating activities on October 1st 2002, the 2002 results effectively cover only the fourth quarter of 2002.

***Restructuring of the Company***

The most important factor for the 2003 results were the steps taken by the Issuer's Management Board with a view to improving the Company's profitability, after the Company was acquired by the current President of the Management Board. The restructuring essentially involved the following actions:

- *Cost restructuring and centralisation of management functions* – centralisation of management and administrative functions, and strict cost control facilitated a significant cost reduction at the level of individual Discount Cash & Carry. Moreover, the optimisation of Discount Cash & Carry activities resulted in further savings. The Company's head office also underwent a major reorganisation, which increased the Company's effectiveness.
- *Restructuring of the "abc" shop chain by focusing on more attractive locations* – in the first year of the restructuring process, Eurocash terminated franchise agreements with almost 600 out of the 1,700 existing "abc" shops and expanded the chain by 700 new shops. Moreover, an incentive system for the best shops was introduced. These initiatives brought about an approx. 17% increase in the value of average purchases made by the "abc" shops in the first nine months of 2004, compared with the analogous period of 2003.
- *Introduction of a new incentive system for employees* – employees were offered an incentive system strictly linked to the Company's results. Sales, margins, goods turnover, and loss and bad credit reduction are now the parameters determining their remuneration. At the same time, Eurocash decentralised responsibility and maintained centralised systems of ongoing control.
- *Redefinition of the wholesale concept* – immediate actions were taken to change the warehouse stores' arrangement and structure, with a view to modifying the goods range and adjusting it to the projected fast goods turnover. Furthermore, the price (margin) policy was changed and the marketing activities reviewed.

The restructuring actions resulted in the Discount Cash & Carry concept being created. Its management structure facilitates providing incentives to employees, and ensures control and effectiveness of operations, while maintaining low operating expenses and capital expenditure. The restructuring also pertained to the "abc" shops chain.

***Acquisition of Know-How***

In March 2003 Eurocash and Politra entered into an agreement concerning a licence to us know-how (described in detail in Section 8 of Chapter V). In 2003, the payments related to the agreement amounted to PLN 8,709 thousand and in the period from January to the end of August 2004 – PLN 6,957 thousand.

On August 18th 2004, Eurocash and Politra agreed to terminate the licence agreement. Pursuant to the termination agreement, Eurocash acquired the know-how from Politra for the price equal to all future liabilities due under the licence agreement. The amount of the future liabilities was estimated at PLN 52,403.3, and the acquisition price was EUR 11,796,418.

In connection with the one-off payment of the future liabilities under the agreement, the acquired know-how was posted to intangible fixed assets and is amortised on a straight-line basis over a period of 60 months. The monthly amortisation charge is PLN 905.4 thousand.

Table VI.6. Know-how amortisation plan

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|
| Know-how amortisation (PLN '000) | 3,633.2 | 10,899.6 | 10,899.6 | 10,899.6 | 10,899.6 | 7,266.4 |

***Repayment of a Loan Granted by Jeronimo Martins Dystrybucja***

In October 2003, the Company received a loan from Jeronimo Martins Dystrybucja in the amount of PLN 30,422.5 thousand. In January–September 2004, the loan interest payments were PLN 3,095 thousand. On September 14th 2004, Eurocash repaid all of its liabilities under the loan, therefore they will not have a bearing on net profit in the years to come.

***IT System***

In 2004, Eurocash replaced the old IT system – temporarily shared with the Jeronimo Martins Group – with a new system. Main expenses related to the new system included:

- migration of the SAP system with the Oracle database and the Data Warehouse system from the Jeronimo Martins Dystrybucja environment to the new Eurocash environment;
- equipment (servers, drive arrays, workstations, network infrastructure);
- integration of the new IT system.

The implementation work started in 2003 and finished in 2004, with a major part of the project complete. In 2003, the system implementation expenses amounted to PLN 268 thousand, and in 2004 – PLN 12,406 thousand. No significant expenses connected with launching the new IT system are expected until the end of 2004.

***SAP Licence***

On October 18th 2004, the Issuer concluded an agreement with Kipi whereby the Issuer acquired all Kipi's rights and obligations under the Licence Agreement, described in Section 10.2 of Chapter V. On October 18th 2004, the licence for the "mySAP Business Suite" software and the "ORACLE Database" was granted directly to Eurocash by SAP.

## 3. Development Trends in Business Activities since the Most Recent Financial Statements

In the period between the date of the most recent financial statements presented in this Prospectus (July 31st 2004) and the date this Prospectus was updated, there were no material changes in the Company's business other than those described in Section 2 of this Chapter VI.

## 4. Factors Material to the Development of the Issuer and Forecasts concerning the Development of the Factors in the Future, as well as Prospects of the Issuer's Operations

### *4.1. External Factors*

#### *4.1.1. Poland's Economic Growth*

The rate of economic growth, households' income, and other macroeconomic factors have a considerable influence on households' spending and the rate of growth of domestic demand, and therefore have an impact on the Eurocash revenue. Since the second half of 2003, the economic situation in Poland has been improving. If the current trend continues, it should positively effect the Company's performance. However, it is important to stress that the demand for the basic products, including but not limited to food products and daily-use products, which are the core goods offered by Eurocash, is relatively less sensitive to fluctuations of the economic situation.

#### *4.1.2. Competition and Changes in the Structure of Polish Retail and Wholesale Market*

According to CAL the number of companies on the wholesale market fell in 1994–2002 by over 50%, which was accompanied by an increasing growth in importance of the large wholesale chains which can offer competitive terms to their customers. The Issuer expects that the reduction of the number of local and regional warehouse stores should be expected to be followed by growing significance of large, countrywide or supraregional wholesale chains.

In the Issuer's opinion, the retail market will in turn witness an increasing growth in importance of retail chains comprising many companies, which facilitates obtaining better purchase terms and offers the benefits of joint promotion and shared logistics policy.

#### *4.1.3. Retail Market Regulations*

In the opinion of the Management Board, any potential changes to regulations, especially related to trade, labour and consumer law, might affect the activities of the Issuer. The currently observed tendencies to regulate some of the trade activities might result in a more favourable environment for small and medium groceries, at the expense of large retail networks in the modern distribution channels. However, the Management Board does not expect those changes to have a material effect on the Issuer's market position.

### *4.2. Internal Factors*

#### *4.2.1. Management*

The feasibility of the planned development strategy depends largely on the professional expertise of the Eurocash management. The Company's Management Board and chief operating managers have vast experience, unique on the Polish market, in developing large distribution chains, both in Poland and abroad. The majority of the Executive Committee members have over 10-year experience in the retail sector and have participated in management of companies in favourable and unfavourable market conditions. The remuneration system for the management, as well as for other employees, depends to a large extent on the Company's performance. The Company plans also to implement a new Incentive Scheme for key managers. For a detailed description of the Incentive Scheme see Section 6 of Chapter III.

#### *4.2.2. Limited Needs for Financing*

In the opinion of the Company, low marginal costs of expansion is one of the most important factors affecting competitive position of the company. Considering the fact that new warehouse stores are being set up in existing buildings it is of vital importance for the development strategy that the opening of a new Discount Cash & Carry on an agency basis involves only limited financial expenditure, related only with purchase of selected basic equipment, e.g. storage shelves, refrigerators, entry control system, pallet-lifts, advertising signs, and computer hardware. Low expansion costs and needs for financing do not increase investment risk.

#### *4.2.3. Logistics Development*

In view of the planned expansion, the Eurocash Management Board has made a decision to change the location of the distribution centre in Poznań. The new distribution centre is to consist of a warehouse part (approximately 20,000 $m^2$) and an office part (approximately 3,200 $m^2$). In the long-term perspective, it is also planned to house the Company's head office. The warehouse is scheduled for commissioning for June 2005, and the offices for October 2005.

According to the plans of the Issuer's Management Board, the change of location will bring about no substantial change of the costs of leasing distribution centre premises. At the same time it will ensure a far larger warehousing area, which should contribute to improved efficiency of the distribution centre and will provide conditions for further development of the scale of the Company's operations.

#### 4.2.4. IT Systems

An efficient computer system is a key element of an efficient distribution network. The head office, the distribution centres, and the individual Discounts Cash & Carry operate using a state-of-the-art, fully-integrated "mySAP Business Suite" computer system, and an extensive "ORACLE Database" containing over 60,000 registered active customers. The database supports analyses of customer behaviour and efficient marketing communication.

The functionality of the system constitutes the information platform for the management. The system enables to manage working capital in real time at the level of each Discount Cash & Carry, analyse sales by particular products and customers, optimalise supplies and transport, and analyse each trade credit granted. Daily monitoring enables current control over the Company's activities. The system is also used by the Company's management when making the majority of business decisions and enables a prompt reaction to the market needs.

## 5. Development Strategy and Investment Plans of the Issuer

### 5.1. Development Strategy of the Discount Cash & Carry Chain

The current development strategy of Eurocash is specifically tuned to meet the requirements of the Polish market. Factors of crucial importance are the predominance of traditional wholesale distribution channels, demographic structure (large number of small towns and villages), and preferences of the Polish consumers opting for frequent shopping of relatively smaller value (and size). In view of the above, the Issuer's Management Board decided to continue the adopted development strategy, which consists in the deepest possible targeted market penetration, possible thanks to the low expansion cost and tailoring of the offer to the needs of the targeted group of customers (small and medium-sized shops).

In the opinion of the Issuer's Management Board the Polish market's potential can eventually support up to approximately 150 Discounts Cash & Carry. The Issuer plans a further development of Discount Cash & Carry chain and estimates that the total number of the stores may amount to 100 in the subsequent two years. The Management Board expects that the majority of Discounts Cash & Carry will operate on the basis of agency agreements.

The agency agreement model is the Issuer's preferred organisational model for new Discounts Cash & Carry. Stores under agency agreements offer only Eurocash-owned goods intended for sale by agents. Agents are required to observe the rules of procedure and instructions as well as price lists established by the Company. The agents are remunerated on a commission basis, and commission fees depend on the turnover. Each new potential Discount Cash & Carry location is thoroughly evaluated by Eurocash with respect to such factors as the population, its affluence, existing competition, the number of stores in the neighbourhood, etc.

It is of vital importance for the development strategy that the opening of a new Discount Cash & Carry under the agency model involves only limited financial expenditure. In the opinion of the Management Board, low marginal costs of expansion and flexibility (most of the items are movable and may be utilised in other stores) enables Eurocash to penetrate the market more effectively than it is the case with many competitors, and reduces the investment risk. Concurrently with opening new Discounts Cash & Carry, the Eurocash Management Board expects expansion of the sales in the existing Discount Cash & Carry chains.

The Management Board of Eurocash also sees potential development opportunities in selective acquisition of local mid-sized wholesalers, with the aim to achieve economies of scale and to make fuller use of the logistics possibilities.

### 5.2. Development Strategy of the Chain of "abc" Franchise Stores

Simultaneously with the development of the chain of Discounts Cash & Carry, Eurocash plans the expansion of its chain of "abc" franchise stores. The Company forecasts that by the end of 2004 the "abc" chain will consist of approx. 2,000 outlets (compared with 1,838 as at the end of September 2004).

Similar to that of the Discounts Cash & Carry, the dynamic development of the "abc" chain is possible due to its low marginal costs of acquisition of new shops. In the opinion of the Management Board, the dynamic development of the chain of "abc" stores and the successful partnership-based formula of co-operation with the shop owners create significant opportunities for the implementation of innovative projects leveraging the advantages of a nationwide distribution network.

### 5.3. *Investment Plans and Assessment of Their Feasibility*

The Company plans to undertake several investment projects, mainly related to the expansion of Eurocash. The most important investment projects will include:

- Opening of new Discounts Cash & Carry in 2004–2005 and maintenance of existing network; and
- Development of logistics, including in particular the planned relocation of the Poznań distribution centre in 2005.

In the first nine months of 2004, the main, already completed investment concerned the new IT system, which replaced the old one shared with the Jeronimo Martins Group.

The table below summarises the capital expenditure programme assumed by the Company's Management Board.

Table VI.7. Capital expenditure programme for 2004–2008

| thousand PLN | 2004 | 2005 | 2006–2008 (total) |
|---|---|---|---|
| New Discounts Cash & Carry, maintenance and repairs | 4,400 | 19,000 | 23,400 |
| Logistics | 390 | 3,900 | 6,900 |
| Head office | 15,400 | 4,500 | 8,200 |
| **Total investments** | **20,190** | **27,400** | **38,500** |

*Source: the Issuer*

The Issuer plans to finance the above capital expenditure with own funds generated by current operating activities.

## 6. Management's Forecast of Financial Results

### 6.1. *Management's Forecast of Financial Results for 2004*

The Company's development in 2004 is proceeding in line with the Issuer Management Board's expectations. The table below sets forth the Issuer Management Board's forecast of the main financial results, the actual figures for the first nine months of 2004 and the data for 2003.

Table VI.8. Management's forecast of financial results for 2004

| | 2004 budget value | Actual figure for Jan-Sep 2004 | Actual figure as % of budget value | 2003 |
|---|---|---|---|---|
| Sales revenue (PLNm) | 1,582 | 1,196.0 | 76% | 1,374.5 |
| EBITDA (PLNm) | 49 | 35.2 | 72% | 19.3 |
| Operating profit (PLNm) | 27 | 21.5 | 79% | 5.9 |
| Net profit (PLNm) | 21 | 17.1 | 81% | 4.1 |

*Source: the Issuer.*

***Transfer of the Expenses Related to Licence Payments***

In March 2003, Eurocash entered into a licence agreement with Politra (described in detail in Section 8 of Chapter V). In 2003, the payments related to the agreement amounted to PLN 8,709 thousand, and in the period from January to the end of August 2004 – PLN 6,957 thousand, and were posted to other operating expenses. On August 18th 2004, Eurocash and Politra agreed to terminate the licence. Pursuant to the agreement, Eurocash made a one-off payment of the future liabilities under the licence agreement and acquired the know-how from Politra. In connection with the one-off payment of the future liabilities under the licence agreement, the acquired know-how was posted to intangible fixed assets and is amortised using the straight-line method over a period of 60 months. In order to facilitate comparability of the future financial results, the licence payment expenses recorded in 2003 and in the period from January to August 2004 as other operating expenses were transferred to amortisation cost. Consequently, the EBITDA increased by PLN 8,709 thousand in 2003 and by PLN 6,957 thousand in 2004, both in the results for January–September 2004 and in the budget for the whole of 2004.

The table below sets forth the main financial data adjusted for the effect of the one-off payment of the future liabilities under the licence agreement with Politra. It will facilitate comparability of the presented data with the actual results for the future years.

Table VI.9. Management forecast of financial results for 2004 (EBITDA adjusted for the effect of non-recurring events)

| | 2004 budget value | Actual figure for Jan–Sep 2004 | Actual figure as % of budget value | 2003 |
|---|---|---|---|---|
| Sales revenue (PLNm) | 1,582 | 1,196.0 | 75% | 1,374.5 |
| Adjusted EBITDA* (PLNm) | 56 | 42.2 | 76% | 28.0 |
| Operating Profit (PLNm) | 27 | 21.5 | 79% | 5.9 |
| Net profit (PLNm) | 21 | 17.1 | 81% | 4.1 |

** Adjusted EBITDA: operating profit + amortisation + licence payments to Politra in a given period.*

*Source: the Issuer.*

### *6.2. Forecast Period*

The forecast concerns the period January 1st – December 31st 2004.

### *6.3. Forecast Assumptions*

The forecast was based on the following assumptions:

- More than 15% increase in sales as compared with 2003.
- 2,000 "abc" shops at the end of 2004.
- 3.5% EBITDA margin (adjusted).
- 1.3% net profit margin.

### *6.4. Monitoring of the Actual Results against the Forecast*

The Company will monitor the feasibility of meeting the forecast on a regular basis. The monitoring will be supported by an analysis of the sales revenue and incurred expenses.

### *6.5. Forecast Assessment Periods*

The performance of the forecast will be assessed on a monthly basis. If the actual results deviate by at least 10% from the forecast, an adjustment will be made by the end of December 2004.

Simultaneously, the Management Board will regularly provide information on significant transactions involving the tangible fixed assets and financial assets. It will also present their possible influence on the presented forecasts.

## 7. Liabilities under Bond in Issue

In connection with the planned issue of bonds with pre-emptive rights as part of the Incentive Scheme (described in Section 6 of Chapter III), the expected value of liabilities under the issue of Series A Bonds will amount to PLN 1,277.42, and under Series B Bonds also PLN 1,277.42. The total value of liabilities under the bonds will reach PLN 2,554.84.

In addition to its obligation to redeem the Bonds, the Company will be obliged to issue Shares for any Bondholder who chooses to exercise his/her pre-emptive rights. The Incentive Scheme Resolution states: "*If the shares are not delivered to the Bondholders, the pre-emptive rights to the shares shall be transformed into the rights to receive a cash amount equal to the market value of the shares as at the scheduled delivery date*". A detailed description of the Issuer's obligations under the Bonds will be defined in the terms and conditions of the Bonds.