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Management Review

1. CEO Report

The recovery in the livestock production industry in the EU is a reality

For most primary agriculture enterprises in the EU, 2016 will be remembered as the year when the long-awaited recovery in prices and profitability finally arrived, particularly in the milk and pork sectors, and a prolonged period of loss-making production was transformed into reasonable profitability. The many years of poor earnings for livestock producers in the EU have resulted in significant liquidity problems for many farmers, and has left a production system that urgently requires a comprehensive upgrade after many years with little financial scope for maintenance and improvements. It may be hoped, therefore, that the improved profitability will continue for several years to come, so that the majority of farmers can catch up.

The Axzon Group once again experienced a year with both positive and negative circumstances, which is almost always the case for a fully integrated production system within the food sector, where higher prices and improved profits in the primary sector, often lead to more difficult market conditions and lower profitability in the processing sector. When production and markets are also dispersed over a wide geographic area, as in the case of Axzon, such diversified production usually results in more stable earnings, based on an equalization and neutralization of the worst elements of risk.

The year was again marked by major improvements in efficiency in almost all areas of both production and administration, and there was a stable and even decreasing cost level per unit produced, combined with increasing production volumes. While the first 6 months of the year were characterized by very low prices in Russia, Ukraine and Poland, continuing the pattern of historically low prices at the end of 2015, the second half of the year saw the start of a marked increase in pork prices in the EU, while especially in Ukraine, prices remained historically low.

Unfortunately, one of the Group’s Russian facilities was affected by African swine fever, just as earnings in Axzon were generally moving in a very positive direction. Apart from the immediate economic loss of about DKK 35 m, this was a terrible experience, both physically and mentally, for the company generally, but of course most of all for the employees at the farm.

The key earnings parameter in Axzon’s pig production is the conversion ratio between feed and meat. The chart (Fig. 1) clearly illustrates that there has been a significant equalisation of the ratio between the three countries, where Ukraine and Russia have experienced a marked deterioration of the ratio, while Poland has seen a strong improvement in 2016, particularly in the last half of the year, when the conversion ra-

tio reached 7.24, which is the highest level achieved in the country in the last 7 years. The reason for the sharp increase in the price of pork in the EU, is a significant slowdown in output growth and a significant increase in exports to the world’s largest consumer and producer of pork, namely China. The majority of analysts worldwide had predicted declining production in China as early as 2015. This was based on a significant decrease in the number of pigs in stables in the country, but surprisingly, the effect was not felt until 2016 and it is expected to continue over the coming months and perhaps years. China produces and consumes about 50% of world pork, and with a price that is currently around twice the average price in the rest of the world, this bodes well for future trends.

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nomic and cultural integration. These circumstances highlight the value of being represented with production across different countries and regions, both because it encourages integration across the countries, but also because it ensures sales in case of trade disputes. If there are also countries that have large surpluses of cereals and other commodities, then a competitive advantage can be retained, especially compared to countries like China, where domestic production is limited by both the environment and the supply of raw materials. Russia and the Russian embargo is a good example of this. EU producers were left in a sales vacuum by the embargo, whereas Axzon benefited from good price conditions in both Ukraine and Russia. Russia’s response to the protracted conflict with Western Europe and the United States has been to work towards a very high level of self-sufficiency, especially in the food sector. This policy has paid off dramatically, and the country is now very close to being self-sufficient in pork, so that prices in future will probably be closer to the international level. The sanctions against Russia, and the opposing embargo on food, in conjunction with the general conflict between East and West, have left Ukraine in a kind of vacuum between the parties, even though the majority of the country’s population would clearly like to join Western Europe. The ongoing war-like situation in some of the eastern provinces, has had a very negative impact on the country’s economy, and thus on the population’s purchasing power and living standards. Although over the past year the country has adopted a raft of new laws and regulations based on EU recommendations, which will hopefully make the country more democratic and less corrupt, their implementation in practice has been very slow, and the anticipated improvement in the country’s economic development has not yet been realised. The past year has been extremely difficult for the country’s pig farmers, and even with a very low level of consumption in the country (under 15 kg per inhabitant), Ukraine is still not self-sufficient in pork, since a large part of the production is in the process of being phased out due to the very poor price conditions. Axzon has in Ukraine the lowest breakeven point in the whole group, despite the poor price conditions, a profit can still be generated in Donbas. Obviously, this looks good for the coming years, where consumption is likely to rise at a somewhat faster pace than production, and where the current restriction on exports from the country due to ASF will hopefully be replaced by the opportunity to export from a country where, assuming a good level of production efficiency, the production costs are exceptionally low.

As we know, Axzon has expanded its production considerably over the past few years, both within and across the geographic area, but also in terms of ensuring the fully integrated production model from “field to table”. Due to a slightly tighter liquidity situation, especially in the first half of 2016, there has been a strong focus on prioritizing among the planned investments. Investments were still made across all businesses and production sectors, but the emphasis has been on investments that optimizes the utilization of and earnings from existing production systems, rather than expansion of production levels. It has been a very healthy exercise for the management to prioritize ruthlessly, and also to focus more on investments that promote sales, rather than the typical production-related investments.

A very important investment has been to ensure own production of feed, including in Russia, where a new feed-mill is now ready, together with a significant increase in storage capacity for raw materials, both here and in the other primary companies. There was also a great deal of investment dedicated to improving biosecurity in and around all of our production units in relation to preventing the spread of diseases, especially African swine fever. During the past year, the disease spread even further to the west, and it can now also be found in Italy and has therefore almost reached the heart of Europe. There is a major risk, therefore, that it could spread to areas in Europe where the animal density is highest and where, at the same time, the largest populations of wild boar can be found. (For example, in western France, northern Spain and large parts of Germany).

Last but not least, the final phase of the expansion of Prime Food has been completed. In addition to increasing efficiency, the investments have also made it possible to produce more speciality products, thereby differentiating a higher proportion of the products from the typical bulk products. The strategy of expanding the section for pre-packaged fresh meat (Modified Atmosphere Packing or MAP) and fully processed products has been implemented as rapidly as possible, and with a significant upgrading of the technical aspects of this production sector, the difference in the gross margin between ordinary de-boned meat and the processed goods has become even larger (see the graphs).

The move towards producing a greater number of speciality products has also been a priority for Axzon in the past year, and especially the fully in-
tegrated production in Poland, through Poldanor and Prime Food, has made it possible to produce a range of products that clearly differs from the usual bulk products. It is no longer "only" traceability, quality, food security and CO2-neutral production that characterizes the products. Now, speciality products are also produced that are based on pigs that have been fed GMO-free feed or other speciality feed material, pigs bred without the use of antibiotics, and even other genetic compositions of the animals, which produce a different appearance and flavour. Since these special products are also processed and packaged under optimal conditions, for example without additives, they are actually products that differ significantly from the majority of the products currently sold in the retail sector, and products that appeal to consumers who prioritise food safety, animal welfare and environmental impacts.

It is precisely in these areas that Axzon can and will specialize even more in the coming years. Fully integrated production has proven to be the correct strategy, not just financially, but also in terms of climate and sustainability. It is important now to further differentiate ourselves from the bulk market, also in terms of providing fully processed goods directly to the consumer. This will require additional investments related to

slaughter and processing, certifications and training of staff, but will also require more targeted marketing and the establishment of sales channels closer to particular consumer groups.

There is a tendency among many people to fear the future and the unknown, and the creeping protectionism we see is a further manifestation of this trend. With more than 2,000 employees in four countries, Axzon is working for the opposite view and direction, i.e. greater openness, integration and tolerance. The company invests a great deal of time and energy in training staff in all parts of the organization, not only professional training, but also personal development of managers, as well as discussion and adoption of common attitudes and values across national borders and cultures. A common approach to the development of the company, exciting opportunities and challenges in the future, common values and the ability and the desire to use the most modern and efficient equipment, are precisely what enables the company to achieve optimal results using the fewest resources and with the least possible negative impact on our shared environment.

All of these initiatives have helped bring us all closer together in the company in the past year, and I am personally very proud, both of the fantastic production results that have once again been improved in many of the key areas, but also of the way our common values have been implemented in virtually all branches and localities in the company, despite our very different backgrounds. This has also been noticed and appreciated by society around us, and it characterizes our relationship with most of our business contacts.

With the prospect of an even better year in 2017, when the long-awaited recovery will take hold, not just in Axzon’s industry, but generally in the society around us, I would like to thank all our staff, boards of directors, business associates and other Axzon stakeholders for a positive and ambitious year. We are now better equipped than ever before to tackle the exciting challenges ahead.

Tom Axelgaard
CEO Axzon
2. Finances

For Axzon, 2016 was the year when the long-term challenges with regard to pork prices were replaced by the long-awaited price increases. Compared to the price levels in 2015, sales of first-class finishers brought in DKK 41 m less than if the same animals had been sold at 2015 prices. The price trend moved in the opposite direction between first and second half of the year. In the first half, sales were DKK 25 m higher if the same comparison to 2015 prices was made. These circumstances, in conjunction with the outbreak of ASF at the DAN KUB farm in Krasnodar, made it difficult to achieve the planned results.

A positive factor, however, was that the price of the green certificates that, under the new legislation in Poland, Axzon can sell in connection with the production of biogas, has again reached a reasonable level. Against this background, Poldanor in Poland managed to produce biogas with a positive result in the second half of the year. It has thus been possible to improve revenue by 9% and EBITDA by 21% before special costs (ASF), and by 15.6% after these costs. This trend bodes well for next year's results.

Depreciation increased by DKK 36 m, despite a reduction in the rate of investment. This was partly due to increased depreciation on the ongoing revaluations, and partly a write down of the plant in Krasnodar by DKK 11 m as a result of the ASF, which together accounted for one third of the increase in depreciation. The increase in interest expenses of DKK 15 m was partly due to increased interest rates, and partly the growth in debt in 2015. The increase in interest rates was due to both a higher risk premium and to new loans raised at higher interest rates that were used to replace older and less expensive loans.

Movements in currency exchange rates have had a strong impact on Axzon’s operating profit over the past two years. With a loss of DKK 13 m, this item had only limited influence this year. Underlying, there has been a small gain in Russia, since RUB has increased, while UAH fell, leading to a loss in Ukraine. Intercompany loans to Russia are subordinated and considered part of the net investment in the subsidiary. As such the exchange gains on these loans are recognised through other comprehensive income.

2016 has been a positive year for Axzon in terms of cash flow. The cash flow from operating activities amounted to DKK 227 m, of which DKK 139 m was used on investments, DKK 71 m was used to reduce debt, and the remaining DKK 17 m was used to improve the cash balance. The strong cash flow was achieved in a period with challenging pricing for finishers. In 2014, the price for finishers was generally regarded as being too low and below profitability level, especially in the EU. For comparison, if 1st class finishers had been sold in 2016 at the same price as in 2014, the sale of these pigs would have brought in DKK 283 m extra, and would thereby have increased the cash flow from operations by the same amount, or by 147%. Due to the falling prices, Axzon has broken some of the covenants that the Group is subject to in relation to agreements with some of its lenders, which are based on a very steep repayment profile. Subsequent waivers from the same lenders, however, have solved this problem. Since the arrangement was not formally in place at year end, IFRS requires that loans from key lenders should be recorded as short-term liabilities, regardless of the agreed repayment horizon. For this reason, the accounts show that Axzon has a current ratio of 70, whereas it should be 130 according to the concluded agreements. Without this reclassification of the loans, the current ratio would have been 150. Based on the strong underlying cash flow, however, this situation has never caused any problems.

The equity increased during the year from DKK 1.673 m to DKK 1.735 m. In terms of profit, DKK 95 m has been added, but an exchange rate depreciation on the subsidiaries’ equity has reduced the equity by DKK 28 m, and a reversal of revaluations directly in the equity as a result of ASF in Krasnodar, has reduced equity by another DKK 9 m.

A net profit of less than DKK 100 m is below what is expected for Axzon, but especially considering the poor pig prices in the first half of the year, and the costs associated with the ASF outbreak in Krasnodar, the results must be considered highly satisfactory.

### Finances

<table>
<thead>
<tr>
<th>Fig. 8. Change in financials</th>
<th>2016</th>
<th>2015</th>
<th>Index Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,391,385</td>
<td>1,275,255</td>
<td>109 116,130</td>
</tr>
<tr>
<td>Change of value in biological assets</td>
<td>48,794</td>
<td>52,854</td>
<td>92 4,060</td>
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<tr>
<td>Grants and other income</td>
<td>53,396</td>
<td>41,903</td>
<td>127 63,411</td>
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<tr>
<td>Total revenue</td>
<td>1,493,575</td>
<td>1,370,012</td>
<td>109 121,563</td>
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<tr>
<td>Changes in inventories and work in progress</td>
<td>-6,427</td>
<td>-8,581</td>
<td>75 1,154</td>
</tr>
<tr>
<td>Cost of materials and services</td>
<td>943,138</td>
<td>890,968</td>
<td>106 2016</td>
</tr>
<tr>
<td>Other external expenses</td>
<td>24,652</td>
<td>22,498</td>
<td>106 171,602</td>
</tr>
<tr>
<td>Total costs</td>
<td>961,363</td>
<td>904,885</td>
<td>106 56,478</td>
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<tr>
<td>Gross profit</td>
<td>532,212</td>
<td>465,124</td>
<td>114 1,191,385</td>
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<tr>
<td>Staff expenses</td>
<td>188,419</td>
<td>181,523</td>
<td>104 7,896</td>
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<tr>
<td>EBITDA</td>
<td>343,793</td>
<td>283,604</td>
<td>121 95,554</td>
</tr>
<tr>
<td>Special items</td>
<td>16,029</td>
<td>16,029</td>
<td>100</td>
</tr>
<tr>
<td>Depreciation and impairment of fixed assets</td>
<td>126,952</td>
<td>120,534</td>
<td>124 6,419</td>
</tr>
<tr>
<td>EBIT</td>
<td>171,602</td>
<td>163,085</td>
<td>105 32,933</td>
</tr>
<tr>
<td>Interest</td>
<td>63,411</td>
<td>48,262</td>
<td>131 15,149</td>
</tr>
<tr>
<td>Exchange rate adjustments</td>
<td>-13,051</td>
<td>-69,507</td>
<td>19 56,456</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>95,140</td>
<td>45,316</td>
<td>210 49,824</td>
</tr>
<tr>
<td>Tax</td>
<td>-136</td>
<td>4,163</td>
<td>19 -4,300</td>
</tr>
<tr>
<td>Minority interest</td>
<td>-78</td>
<td>31</td>
<td>252 -109</td>
</tr>
<tr>
<td>Net profit to Axzon shareholders</td>
<td>95,554</td>
<td>41,122</td>
<td>232 54,432</td>
</tr>
</tbody>
</table>
### Market situation in Axzon

After a generally declining price level throughout 2015, prices had an upward trend in 2016. The lowest prices were in January 2016 and the highest price of DKK 11.67 occurred in September, although this was not as high as the maximum price in 2015 of DKK 12.75. As the graph (Fig. 9) illustrates, however, the price spread between countries has been reduced, and there have not been many significant or sudden changes in the price at Axzon level. The difference between the highest and lowest price in 2016 decreased by 2.58 percentage points from 41.21 to 38.63. The final price was still DKK higher in 2016 than in 2015 (Fig. 10). The higher price was primarily due to higher demand in EU in general, driven by export to China. At the beginning of 2016, Axzon benefited from the high Russian price, since Dan-Invest’s share of all the pigs sold in the group increased from 11.6% in 2015 to 15.6% in 2016. When DAN KUB was hit by ASF, the share decreased again to about 10%. The pork prices in Poldanor experienced less fluctuation over the year, only 41.1%. The price remained relatively stable from January to May, when there was a sudden and large increase. This increase was expected as the maximum price in 2015 of DKK 12.75. As the graph (Fig. 9) illustrates, however, the price spread between countries has been reduced, and there have not been many significant or sudden changes in the price at Axzon level. The difference between the highest and lowest price in 2016 decreased by 2.58 percentage points from 41.21 to 38.63. The final price was still DKK higher in 2016 than in 2015 (Fig. 10). The higher price was primarily due to higher demand in EU in general, driven by export to China. At the beginning of 2016, Axzon benefited from the high Russian price, since Dan-Invest’s share of all the pigs sold in the group increased from 11.6% in 2015 to 15.6% in 2016. When DAN KUB was hit by ASF, the share decreased again to about 10%. The pork prices in Poldanor experienced less fluctuation over the year, only 41.1%. The price remained relatively stable from January to May, when there was a sudden and large increase. This increase was expected but was more marked than anticipated. This increase was caused by the increasing demand from China and a decline in production in the EU. The price ended at DKK 11.33 per kilo HCW, which is nevertheless a significant improvement compared to the final price in 2015 of DKK 9.34 (Fig. 10). The pork prices in Poldanor experienced less fluctuation over the year, only 41.1%. The price remained relatively stable from January to May, when there was a sudden and large increase. This increase was expected but was more marked than anticipated. This increase was caused by the increasing demand from China and a decline in production in the EU. The price ended at DKK 11.33 per kilo HCW, which is nevertheless a significant improvement compared to the final price in 2015 of DKK 9.34 (Fig. 10). The price in Danosha was also somewhat more stable than in the previous year, but at a significantly lower level, with a lowest price in 2016 of DKK 6.63. The price at the end of 2016 was DKK 38.17, which is DKK 3.54 lower than the closing price in 2015. Unlike in 2015, there were no further fluctuations in the currency, so the price graph is mostly a reflection of supply and demand. Meat consumption is usually affected by a weakened currency and a generally poor economy. In this, in conjunction with the generally poor economy in pig production, has caused the pig population and thus production to decline significantly. Similarly, outbreaks of ASF reduced the Ukrainian pig population. In Russia, prices have also been more stable than in 2015, with a fluctuation of only about 77%, compared to 92.4% in 2015. ASF also caused prices to rise here. A total of 233,000 pigs were culled due to ASF in Russia.

### Table: Pig prices in Axzon Group

<table>
<thead>
<tr>
<th>Company</th>
<th>Period</th>
<th>Currency</th>
<th>Min. price in DKK</th>
<th>Max. price in DKK</th>
<th>Difference in % from min. price to max. price in DKK</th>
<th>Ultimo price in 2015 in local currency</th>
<th>Ultimo price in 2015 in DKK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poldanor</td>
<td>2016</td>
<td>DKK</td>
<td>8.83</td>
<td>12.46</td>
<td>41.11</td>
<td>11.33</td>
<td>11.00</td>
</tr>
<tr>
<td>Danosha</td>
<td>2016</td>
<td>DKK</td>
<td>6.63</td>
<td>9.69</td>
<td>46.22</td>
<td>8.92</td>
<td>11.74</td>
</tr>
<tr>
<td>Dan-Invest</td>
<td>2016</td>
<td>DKK</td>
<td>8.46</td>
<td>15.00</td>
<td>77.33</td>
<td>15.00</td>
<td>12.41</td>
</tr>
<tr>
<td>Axzon</td>
<td>2015</td>
<td>DKK</td>
<td>8.75</td>
<td>12.35</td>
<td>41.21</td>
<td>11.84</td>
<td>10.71</td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>DKK</td>
<td>8.42</td>
<td>11.67</td>
<td>38.63</td>
<td>10.74</td>
<td>9.54</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Difference</td>
<td>-0.33</td>
<td>-0.68</td>
<td>-0.74</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Index 2015 to 2016</td>
<td>96</td>
<td>94</td>
<td>94</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The pork prices in Poldanor experienced less fluctuation over the year, only 41.1%. The price remained relatively stable from January to May, when there was a sudden and large increase. This increase was expected but was more marked than anticipated. This increase was caused by the increasing demand from China and a decline in production in the EU. The price ended at DKK 11.33 per kilo HCW, which is nevertheless a significant improvement compared to the final price in 2015 of DKK 9.34 (Fig. 10). The price in Danosha was also somewhat more stable than in the previous year, but at a significantly lower level, with a lowest price in 2016 of DKK 6.63. The price at the end of 2016 was DKK 38.17, which is DKK 3.54 lower than the closing price in 2015. Unlike in 2015, there were no further fluctuations in the currency, so the price graph is mostly a reflection of supply and demand. Meat consumption is usually affected by a weakened currency and a generally poor economy. In this, in conjunction with the generally poor economy in pig production, has caused the pig population and thus production to decline significantly. Similarly, outbreaks of ASF reduced the Ukrainian pig population. In Russia, prices have also been more stable than in 2015, with a fluctuation of only about 77%, compared to 92.4% in 2015. ASF also caused prices to rise here. A total of 233,000 pigs were culled due to ASF in Russia.
3.1 The market situation in Poland

Prices in Poland were very low from mid-2014 to mid-2016, partly because of the Russian ban on imports, and partly due to increasing levels of production in the EU. After 2 years of low prices, however, pork prices improved in the second half of 2016. The Polish price in October 2016 was PLN 5.02, which was about 15% higher than at the same time last year. In both 2015 and 2016, the Polish price remained slightly below the German price by about EUR 0.06/kg live weight, although this was mostly based on a changed exchange rate between PLN and EUR. There was greater international demand for pork in 2016, mainly driven by China. This caused prices to rise in May, when there was a very rapid and steep increase. This lasted until October, when there was a slight decline that mainly resulted from normal seasonal fluctuations. Prices then remained stable for the rest of the year, and even showed a slight increase towards the end of the year.

3.2 The market situation in Ukraine

The year started with a decrease in prices due to a normal seasonal fluctuation and higher levels of production from the small producers. From 1 January 2016, the Ukrainian parliament also cancelled the import duties of 5% and 10% respectively. Due to the Russian ban on imports from Ukraine, exports fell sharply early in the year to about 10% of the normal level, to 3,000 tonnes for the year. This meant that large producers, who had previously sold for export, were forced to sell their pigs on the local market with low prices as a consequence. In addition to these circumstances, there were about 80 outbreaks of swine fever, which had a significant impact on prices over the year. The rising value of the EUR relative to the UAH, and the resulting decline in imports, resulted in prices starting to rise again in February and they reached about 23 UAH/kg in May. After a slight decline, prices began to increase again due to preparations for the holiday season.

The good weather, and thus the good barbecue season, caused prices to remain high over the summer and they even reached 29.68 UAH/kg, which was very close to the peak price for the same period in the year before. Prices fell again after the summer season, but the price began to rise again already in October because many processing companies purchased early for the Christmas shopping season in 2016, presumably because they feared a shortage during the Christmas season. This subsequently caused the price to fall just before Christmas as stocks were already full.

The political turmoil, the ongoing conflict with Russia and the fluctuations in both pig prices and exchange rates makes it hard to predict the timing and level of future profit in Danosha. These uncertainties are also relevant when assessing the fair values of PP&E, which are further elaborated in disclosure 3. Despite these uncertainties, Axzon still considers Ukraine as an attractive market for pig production in the future, when prices are expected to reach the European levels based on stabilization in the country and access to the export markets.

3.3 The market situation in Russia

Pork prices displayed the same large fluctuations from week to week throughout 2016 as in 2015. The large volatility was due in part to the live weight price being determined based on the price of half-carcases, and since there were significant imports to Russia from countries such as Brazil, this practice causes the price to drop markedly when large shipments of meat suddenly arrive in the country. The large slaughterhouses, who often own substantial processing facilities, will therefore usually refrain from purchasing live pigs while there is cheap meat in the cold stores. The price of live pigs was generally increasing during the first part of the year due to a lack of pigs. This was in part caused by the many outbreaks of ASF, which reduced supply. Consumption continued to decline over the year due to a generally tight Russian economy, which meant that prices decreased during spring. The summer weather caused prices to increase in May, which unusually maintained their level over the summer and into the autumn and early winter, partly as a result of the many ASF outbreaks in late summer.
4. Production

4.1 Pig production

For the first time, ever in Axzon, the number of sows (Fig. 15) declined by more than 5% over a full year. Since Poldanor and Danosha combined have the same number as the year before, the entire decrease came from DAN KUB alone, where the full sow population of 2,700 sows was culled as a result of the ASF outbreak. Productivity improvements meant that Poldanor was able to maintain a share of approximately 53% of all meat sold in Axzon, despite the fact that Dan-Invest contributed approximately 6,000 tonnes of pigs more in 2016 than in 2015. (Fig. 16)

Danosha delivered a very stable output performance, and combined with the increase from Dan-Invest, this means that the company’s relative share of pigs produced fell slightly. Danosha also sold a larger number of pigs as piglets (Fig. 17), which explains why the share of 7-30 kg pigs increased in 2016. Poldanor experienced both increased productivity and rising prices in 2016.

Overall, there was an increase in pigs sold in Axzon of 151,115 pigs, of which 91,475 came from Poldanor and 7,774 from Danosha. Both companies had a stable number of sows throughout the year, and the higher number of sold pigs is therefore a reflection of efficiency improvements in both countries. Dan-Invest accounted for the remaining 51,886 additional sold pigs, due both to efficiency improvements at the Rask farm, and the expansion of the re-launch of the DAN KUB farm in Krasnodar.

The share of piglets and weaners sold increased from 17% in 2015, to 21% in 2016 (Fig. 17 and 18). The number of slaughtered sows remained stable throughout the year, so the increased proportion of piglets has almost only been deducted from the percentage of finishers, which declined from 81% to 77% (Fig. 17 and 18).

The number of pigs in stables dropped from 557,564 to 546,273 (Fig. 23), mainly due to increased sales of piglets in Poldanor and the ASF outbreak in DAN KUB.

The number of liveborn per litter (Fig. 19), weaned piglets per sow (Fig. 20) and pigs sold per sow (Fig. 21) have all increased steadily in recent years. This trend was broken in the course of 2016, however, when most of the key parameters have now stabilized and the Group overall has about 16 liveborn piglets per litter, about 31-32 weaned pigs and about 30-31 pigs sold per sow.
Despite the stagnating and slightly declining results at the end of the year, there were increases in the number of liveborn, weaned and sold pigs per year compared to the last 4 years (Fig. 22), and Axzon set new records on all three parameters in 2016.

Feed consumption calculated according to how many kg of feed is used per kg of pigs sold, including population displacement, remained relatively stable in 2016, with only a slight increase from 2.68 kg to a level of approximately 2.78 for 2016. This is primarily because a greater number of piglets were sold than in the previous year, which means there was a larger proportion of finishers with higher feed consumption in the calculation. The higher feed consumption is therefore not in itself a reflection of poorer feed conversion, but simply the consequence of a different sales strategy.

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Overall, 2016 was a good year for pig production. Despite declining results in the final months of the year, Axzon achieved improvements for all key parameters on an annual basis.

### 4.2 Biogas

The biogas Division has faced some challenges over the years, mainly because this Division, unlike other segments of production in Axzon, is very dependent on various political measures and support schemes. Purely in terms of production, efficiency in the biogas section declined from 86% to 77%. This was primarily due to a technical breakdown at the plant in Danosha. Mechanical damage to the gas generator meant that the plant was at a standstill for several months and therefore achieved an efficiency rate of only 26% for the full year. Efficiency at Poldanor was approximately 85%, which is about 4% lower than the previous year and about 1.5% below expectations.

On the financial side, Poland provided a positive surprise in July, when the Polish parliament passed legislation that industrial energy producers are obliged to purchase a certain percentage of their power from biogas plants. This regulation meant that the financial results were better than expected in Poldanor. The second half of the year reached profitability, whereas the first half of the year was lossmaking, meaning that the full year still ended with a loss of approximately PLN 0.49 m.

### 4.3 Arable farming

Overall, Axzon had a reasonable average harvest of cereals and oil crops, with a yield in tonnes per hectare of 5.10 t against 4.71 t the year before, although with significant variations between countries. The cultivated area for Axzon of 27,526 ha represents a modest increase of 539 ha, mostly from Danosha in Ukraine. Similarly, the distribution between cereals and oil crops was almost unchanged, with about 6% more cereal crops than last year, about 8% fewer hectares of oil crops, and 1% fewer hectares of silage.

The winter weather of 2015-2016 and circumstances related to sowing posed major challenges in all of Axzon’s production countries. In some places, these weather challenges continued over the summer with heavy rainfall. The cereal and oil harvests were long with required many harvest hours, but the quality of the crops was good nevertheless. The average yield of cereal crops was 5.68 t/ha against 3.37 t/ha the year before, a decrease of approximately 13%. As mentioned above, however, there was an overall total increase from 4.71 t/ha to 5.10 t/ha for oil and cereal crops combined, while corn silage provided a yield increase of 46% above the level the year before to 33.89 t/ha.

In 2016, some organisational changes were implemented in the arable farming sectors in each country, most notably in Danosha, where it was possible to reduce the number of employees in arable production by 28% compared to 2015, without impacting the quality of the work. This was demonstrated by a very satisfactory cereal harvest.

In Dan-Invest also implemented some changes, primarily at management level, where a new structure has been introduced. There was an increased focus at the workshops on the training of employees, who received instruction in the use of equipment for error diagnosis. This has resulted in significantly reduced costs for external service.
There was also a focus on machinery strategy in the individual companies, with an emphasis on continuous updating, traction power, spare parts and dealer networks, as well as the use of modern technology, including GPS.

<table>
<thead>
<tr>
<th>Company</th>
<th>Period</th>
<th>Harvested ha</th>
<th>Tonnage ha</th>
<th>Harvested ha</th>
<th>Tonnage ha</th>
<th>Harvested ha</th>
<th>Tonnage ha</th>
<th>Axzon total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poldanor</td>
<td>2016</td>
<td>6,107</td>
<td>5</td>
<td>1,112</td>
<td>2.46</td>
<td>5,404</td>
<td>34.04</td>
<td>12,622</td>
</tr>
</tbody>
</table>
|         | 2015   | 5,519        | 5           | 1,986        | 3.19       | 5,157        | 22.68      | 12,662     
| Difference | 2015-2016 | 588 | 0 | -674 | -0.73 | 247 | 11.36 | 40 | 64,164 | 0.21 |
| Index 2015 to 2016 | 111 | 93 | 56 | 77 | 105 | 150 | 100 | 92 | 96 |
| Danabon | 2016   | 8,155        | 7           | 2,788        | 3.21       | 301          | 31.13      | 11,244     |
|         | 2015   | 7,815        | 6           | 2,396        | 3.64       | 593          | 27.40      | 10,804     
| Difference | 2015-2016 | 341 | 1 | 392 | -0.43 | -292 | 3.73 | 440 | 5,120 | 0.74 |
| Index 2015 to 2016 | 104 | 121 | 116 | 88 | 51 | 114 | 104 | 122 | 114 |
| Dan- | 2016   | 2,919        | 4           | 741          | 2.62       | 3,660        | 10,802     | 3.48      
|         | 2015   | 2,828        | 3           | 636          | 2.92       | 3,464        | 10,364     | 2.99      
| Difference | 2015-2016 | 91 | 1 | 105 | -0.30 | 196 | 2,382 | 0.49 |
| Index 2015 to 2016 | 103 | 123 | 117 | 90 | 106 | 123 | 116 |
| Invest | 2016   | 17,181       | 5.68        | 4,641        | 2.94       | 5,704        | 33.89      | 27,526     |
|         | 2015   | 16,162       | 5.13        | 5,018        | 3.37       | 5,750        | 23.16      | 26,930     
| Difference | 2015-2016 | 1,019 | 0.56 | -377 | -0.43 | -46 | 10.73 | 596 | 71,666 | 0.39 |
| Index 2015 to 2016 | 106 | 111 | 92 | 87 | 99 | 146 | 102 | 112 | 108 |

4.4 Slaughterhouse

The year began optimistically after the good results at the end of 2015. Everyone expected good results for the full year, both in terms of production and on the financial side. Q1 was also ahead of budget for virtually every parameter and the new MAP hall went into operation in May 2016. The barbecue season started at the same time, so everything looked very positive in May.

Over the following months, however, pork prices increased markedly by about 30% and remained at that level until September, when after a slight adjustment downward, they continued at the same level until the end of the year. Commodity prices are particularly important for producers of private label products such as Prime Food, which was severely affected when this was combined with the supermarkets’ reluctance to increase prices in response to a new tax imposed by the authorities. The export restrictions due to the ASF outbreak in Poland in the second half of 2016 also had a detrimental effect. The number of sallughters increased by 8% compared to the year before, as did the volume measured in tonnes, since the purchased weight remained relatively stable. Generally, therefore, there was an increase on the operational side of approximately 7% on the sales side in tonnes, so that the negative result can almost entirely be attributed to low prices for the sales products.

On the sales side, there were several factors that had a negative influence on the result, which only achieved 91.2% of the profits obtained in 2015. These factors included tough negotiations with customers after the commodity prices rose by around 30% in the spring. These negotiations arose primarily from long-term contracts signed with customers at a time when commodity prices were low, and unfortunately this resulted in Prime Food losing good customers. MAP products in particular suffered from this, and sales in this category declined by 40% compared to the first half of 2016. Due to the expanded MAP capacity, however, it was still possible to sell 97% of the volume of MAP sold in 2015.

Sales of processed goods increased by 16.6%, which must be regarded as satisfactory. It is also expected that the share of processed goods will increase further in the future.

2016 generally provided a lower gross margin per kg in both MAP and processed goods, while the gross margin increased for de-boned products and by-products.

Sales of RWA (Raised Without Antibiotics) pigs to a customer in the United States commenced in the autumn, and intense efforts are now underway to expand the customer base for these products into the European market.

As a consequence of the poor sales in 2016, the entire sales department underwent a major restructuring. Seen in conjunction with the new products already available in the shops and the new products in the pipeline, this means that good sales and earnings are expected to return to Prime Food.

5. Risk analysis

Axzon’s operations and the geographical location of its subsidiaries means that the company is exposed to a number of bio-security, political and economic risks. Axzon utilises a structured approach to risk management, where risks are identified, evaluated and handled in accordance with generally accepted principles in this area.

5.1 Bio-security

Ever since Axzon established a more structured approach to risk management several years ago, bio-security, i.e. safeguarding of the company’s herds against infectious diseases, now has the highest priority among threat scenarios. The bio-security risk is handled partly by double fencing of all Axzon’s farms in order to prevent the population coming into contact with wild animals, especially wild boars and rodents, who may be infection carriers. In addition, all trucks coming from outside are disinfected and checked before they enter the farm area. Furthermore, all the animals are loaded and unloaded in a ramp area far from the production buildings. Strict policies and practices have also been implemented among the employees in relation to personal hygiene, handling of dead animals and 48-hour quarantine after contact with animals in another production unit. It is also strictly forbidden for employees to keep pigs privately.

Notwithstanding the measures above, Axzon’s DAn KUB farm in Krasnodar, Russia, was infected with ASF in August 2016. The result was that, in accordance with Russian regulations, about 31,000 animals had to be...
destroyed in the course of a week. Then, also in accordance with the Russian regulations, the farm was disinfect and must be left empty for 12 months before animals can be kept there again.

Axzon has subsequently analysed why the DAN KUB farm was infected, despite its very high level of bio-security. No definitive conclusion was reached. However, 3 hypotheses are being worked with: Firstly, that the farm was infected through a live, statutory vaccine against classical swine fever, which was supplied by a Russian laboratory, which was infected with ASF and closed down shortly after the outbreak at DAN KUB. The vaccine was only administered in the finisher housing units, and this is where the first and also the only outbreak of ASF occurred at DAN KUB.

The second possible source of infection is considered to be horses or mosquitoes that carried infected blood into the stalls and then bit one or more animals, who thus became infected.

The third possible source of infection is thought to be human error, i.e. a breach of the hygiene procedures or a violation of the internal rules regarding the loading of live animals in external trucks. It must be stressed, however, that there is neither evidence nor indications of this. Efforts to determine the source of infection are therefore continuing.

In respect to insurance against ASF, Axzon did not use this option due to the extremely high premium for this type of insurance, as well as from the standpoint that this risk would be managed better by placing production in different countries and in different parts of the countries.

Axzon’s fully integrated business model in Poland also inherently promotes biosecurity, because Poldanor’s full production of pigs is delivered to and slaughtered at the slaughterhouse in Prime Food, to which they are transported in Poldanor’s own trucks. This closed system avoids having external trucks or people involved in the loading or unloading procedures, which are critical from a bio-security perspective. Axzon’s strategy is to have its own slaughterhouse in all the producing countries, and the company is therefore at an advanced stage in its plans to establish a slaughterhouse in Ukraine.

5.2 Political risk

Axzon operates in countries with political and military turmoil and corruption, where Ukraine in particular continued to be marked by the war in the eastern areas in 2016, and by a consequent general economic downturn, which is continuing. In Russia, the economic downturn resulting in part from the rapidly falling oil prices in 2015 and part of 2016, has been replaced by stability, albeit at a low level. Both countries are characterized by corruption, a lack of transparency and contradictory legislation, as well as a high degree of political interference in business.

Axzon still believes that the most effective insurance against political risks is to maintain a good and trusting relationship to all relevant policy levels, as well as local stakeholders, including neighbours, and to ensure that Axzon makes a positive impression wherever it does business. This is e.g. done by supporting local communities with donations for schools, orphanages, cultural centres and by helping with the building and re-construction of roads, snow cleaning etc.

Axzon has also secured support at the supranational level by having the World Bank in the form of the International Finance Corporation (IFC) and the Danish Investment Fund for Developing Countries (IFU) as shareholders in the Group’s Ukrainian company, Danosha. The European Bank for Reconstruction and Development (EBRD) is also among Axzon’s largest lenders. Finally, Axzon is always looking to develop and maintain a close relationship with the official Danish representatives in the countries where the company operates.

5.3 Financial risk

Axzon defines the financial risk exposure as primarily related to interest rates and currencies. Losses on customers is a limited risk, since prepayment is widely used.

Loans are primarily raised at variable interest rates, so that the interest rate stays at market level. Fixed-rate loans are used primarily for capital expenditures, if this is deemed appropriate.

The currency risk is minimized by coordinating payments to the extent possible. Axzon still produces products that are primarily priced internationally, and the prices will therefore follow the world market in the long-term. No efforts are made, therefore, to mitigate devaluation risks in individual countries.

In 2016, Axzon decided to invest in a Business Intelligence System that will be implemented in 2017. Among many other benefits, the system will provide more and increasingly advanced options to monitor financial risk factors.

6. CSR

CSR has been and remains an essential part of Axzon’s DNA, ever since the founding of the first company in the group in 1994. Axzon therefore produces according to the same rules for animal welfare as apply in the EU, even when production takes place in non-EU countries. Axzon also conforms to the Danish or, at a minimum, the local environmental standards applicable in the individual producing countries. CSR at Axzon is defined and measured broadly according to the following main categories: Animal welfare, Environment, Working environment (safety), Food security/quality, Society, HR and Gender. Moreover, a report is prepared each year, with measurements for a number of parameters in relation to the mentioned key categories. Targets are also defined for the following year. Axzon’s Group CSR Report can be downloaded from the following link: http://axzon.eu/wp-content/uploads/2017/03/Axzon_CSR_2016.pdf

In 2016, Axzon launched the implementation of Global GAP (Good Agricultural Practice) certification, which is a recognized international standard for food security, environment and animal welfare. The certifications process is expected to be completed during 2017.

Sustainability is another keyword for Axzon, and it is a concept that is incorporated into everything the company does. The core of Axzon’s sustainability concept is the unique farm to fork concept, which not only includes a fully integrated production in the ordinary sense, but also entails the use of pig manure for energy production in the company’s biogas plants. These facilities supply energy to the farms, which then use the “degassed” solid manure to fertilize the fields, where feed cereal is planted for the animals. This concept is the reason why, for the fourth consecutive year, Axzon in Poland, where the majority of the company’s operations are conducted, has been certified for “Zero CO2 emissions” by the German certification authority, TÜV. Certification was also obtained in 2016 from the prestigious American Humane Association in connection with a collaboration between Poldanor and Prime Food to produce and market the so-called RWA pig, which was mentioned above.

7. Expectations for the future

Due to the low prices in the first half of the year, Axzon delivered results in 2016 that were below expectations for a normal year. At the beginning of 2017, it appears that pig prices are again moving towards a more normal level. In 2016, the result was partly affected by rising pork prices in the second half of the year. In 2017, the same end-adjustment of pig prices is not expected. On the other hand, the average pig price is expected to be higher than in 2016. The DAN KUB farm in Krasnodar is not expected to sell pigs in 2017. The sale of pigs is expected to be around 1.25 m pigs in 2017.

Turnover is expected to be in the range of DKK 1.75 bn, with an EBITDA of approximately 25+ and a net profit of almost 12.5% of turnover. Exchange rate adjustments should be added to or subtracted from this.

In addition to the slightly increasing pork prices, expectations are based on the improved conditions for biogas production in Poland and Ukraine being maintained, on reasonably competitive pressures in the slaughterhouse industry, and on largely unchanged prices for cereals and oilseed crops.
2016 was a very successful year for Poldanor S.A. We achieved very good financial results in a challenging market situation and, at the same time, we improved our production in many ways and added new value to our products, in cooperation with the Prime Food slaughterhouse.

The year started with continuing low pig prices in the market, below PLN 4/kg live weight, but with steadily rising efficiency in our pig production. In May, the expected upturn arrived and pig prices surged to unexpectedly high levels, reaching PLN 5.60 in July. The positive trend continued for the rest of 2016, with more than budgeted feed conversion.

The price of ‘green certificates’ dropped from about PLN 1,100 in January 2016 to about PLN 107 at the end of December 2016, below budgeted and was due to a number of technical challenges.

Arable production was very challenging in 2016. We had to deal with the negative consequences of unfavourable weather conditions in the first quarter of 2016. We had to re-seed about 1,600 ha of land and finally, we harvested quite low yields of cereals and rapeseed. We gathered 2,911 tonnes of cereals and 2,734 tonnes of rape seed. Maize, on the contrary, had perfect growing conditions and this crop allowed us to compensate for the lost income from the sale of cereals and rapeseed. We harvested 183,525 tonnes of maize, 3,260 tonnes of dry maize for feed and we prepared 5,484 tonnes of crimped maize for silage.

In total, we sold 57,020 tonnes of first class finishers in 2016, which was about 5.2% more than in 2015. The constant focus on training staff in animal welfare and the continuous development of improved hospital pens also had a very positive effect on productivity.

In the fattening pigs, we also had good performance, with a constant reduction in mortality and condemned pigs per year, showing inter alia that we have clearly found the right strategy for vaccinating the pigs. The constant focus on training staff in animal welfare and the continuous development of improved hospital pens also had a very positive effect on productivity.

In July 2016, Poldanor and Prime Food finally received QS certification and in September the first RWA and non-GMO pigs were sold from Poldanor to Prime Food. At the same time, both companies were certified by the American Humane Association (American Humane Certified Certification Program). Starting production of RWA pigs in the Bara line was an enormous step for both Poldanor and Prime Food and it opens a new chapter in the Axzon Group. The project has resulted in sales of about 1,000-1,100 RWA slaughter pigs/week since September 2016. We have also used the knowledge gained from this type of production in all other farms in Poldanor in order to reduce the use of antibiotics and, at the same time, to maintain or even improve our productivity.

To meet increasing market demands and to even create them in collaboration with Prime Food, we ran tests for producing differentiated quality meat in 2016. We are working with two approaches. One is by using other genetic lines and testing other boars on our Danbred sows. The other is by using feeding strategies in the last weeks before pigs go to slaughter.

Poldanor’s production
Pig Production, which is Poldanor’s core business activity, proved its strength in 2016. In all phases of production, we accomplished good parameters, in many cases better than expected.

Pig Production, which is Poldanor’s core business activity, proved its strength in 2016. In all phases of production, we accomplished good parameters, in many cases better than expected. Our sow farms produced stable numbers of piglets born alive per litter during the year, and in some periods, we achieved more than 16 piglets per litter. The nurseries had good performances, especially with a lower than budgeted feed conversion.

In the fattening pigs, we also had good performance, with a constant reduction in mortality and condemned pigs per year, showing inter alia that we have clearly found the right strategy for vaccinating the pigs. The constant focus on training staff in animal welfare and the continuous development of improved hospital pens also had a very positive effect on productivity.

In total, we sold 57,020 tonnes of first class finishers in 2016, which was about 5.2% more than in 2015.

Arable
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Biogas
In biogas and energy production, we produced 55,128 MWh of electric energy, which corresponds to an average annual efficiency level of 84.78%. This was about 3.84% lower than in 2015, but only 1.51% lower than budgeted and was due to a number of technical challenges.

The price of ‘green certificates’ dropped from about PLN 110 in January 2016 to about PLN 107 at the end of December from 2016. Poldanor began to receive new ‘blue certificates’ according to the new Act on Renewable Energy. The price of this supporting instrument has been fluctuating around PLN 300, which has significantly improved our profitability.

Fig. 30. Poldanor – pig price (1st class finishers only) within 2016 [PLN/1 kg live weight]
Financial results
The entire Poldanor team is extremely proud of the results achieved in 2016. During more than two years with very negative external factors, we proved that we can focus on the critical factors that we can influence, and at the same time adapt to the restraints arising from the poor market situation. We have focused on our efficiency and the reduction of costs and 2016 eventually gave us an opportunity to harvest the fruits of this dedicated work.

We made major improvements from year-to-year in many areas, such as higher turnover, EBITDA and net results. We ended 2016 with EBITDA at the level of PLN 121,425 T against PLN 77,506 T budgeted.

The feed price during the period was at a lower level than the budgeted price, with an actual price of PLN 969/tonne compared to PLN 1,040 budgeted. This was 2% lower than a year ago. Increasing pig prices mainly affected the meat-to-feed ratio average of 1.643, compared to 1.567 budgeted (slaughter weight). The correlation in 2015 was 1.571.

Animal welfare
Animal welfare has always been a crucial element of Poldanor’s approach to agriculture. In order to meet Danish Pig Research Centre (SEGES) standards, Poldanor has been improving procedures and looking for new, innovative solutions. In 2016, cooling systems were installed in maternity wards at sow farms. Moreover, all sows were given access to toys and the hospital pens at fattening farms were equipped with rubber mats. All sows also received a feed supplement with macro and micro-nutrients, which resulted in a noticeable improvement in their limbs and hooves.

In 2016, the company received quality certificates QS (Bara and Gonne Male farm). The next step, planned for 2017-2018, is to adapt all farms to the Global GAP standards.

We have seen big improvements in pig production due to increased sales prices, as well improved productivity, stable arable production and better results in biogas due to new regulations for the blue certificates system. Externally, we realized 107% of our budget related to the sale of pigs. We sold 684,568 pigs, compared to 642,562 budgeted. This is more than a 18% year-on-year increase.

During the year, our investment expenditure amounted to PLN 25,500 T. This was mainly for the purchase of Agro Gębarzewo land and modernization of Wiesiółka and Zalesie farms and closure expenses at Biogas Bara.

Fig. 31. Gross margin after depreciation by segments

We made major improvements from year-to-year in many areas, such as higher turnover, EBITDA and net results. We ended 2016 with EBITDA at the level of PLN 121,425 T against PLN 77,506 T budgeted.

Fig. 32. Comparison of EBITDA 2012 – 2016

In 2016, the company received quality certificates QS (Bara and Gonne Male farm). The next step, planned for 2017-2018, is to adapt all farms to the Global GAP standards.
Management report
Prime Food

Prime Food’s previous year could be described as two completely different periods. After a great finish to 2015, expectations were much greater for the coming months and years. Belief in the company’s potential was much stronger. Therefore, the company started 2016 prepared, motivated and strongly focused on the objectives of the budget for 2016. All the employees were fully engaged with detailed budget targets and tasks. From the outset, during the very firsts weeks of January, the company started to regularly improve its results, which exceeded December’s achievements and budget expectations. The Q1 2016 performance exceeded even the most optimistic predictions and exceeded the budget forecast. The 2nd quarter started with continued good performance. There was a great start to the barbecue season in early May, and the newly built MAP hall was delivered and commissioned on time. No one expected that the coming months would bring uncertainty. A low population level of pigs in the EU, strongly supported by record-high demand for pork in China, meant that Prime Food experienced a dramatic increase in pig prices throughout the EU during the summer. Within 2 months, prices increased by 30%, and stabilized at that level until the end of September, after which there was a small downwards correction. However, prices remained at a high level until end of the year.

Raw material prices have always had a major influence on a meat processing company’s performance. Extremely high resistance from the market, especially from supermarket chains for price corrections, resulted in the second half of the year being a very challenging period for Prime Food. Export restrictions (due to ASF in the country) posed a major challenge for the company to realize its projected sales margin. Pressure from the supermarkets, which was further influenced by the government announcing a new sales tax, caused many fluctuations in the market. With its strong bargaining position, Prime Food managed to increase most of its prices, but in some cases this lead to changes in the sales structure. With some successes, especially in processed products, and a reduction in MAP sales, the company ended the year with a strong revaluation of our current market position. Having a strong position as a private label supplier has been a considerable advantage, especially when prices for raw materials are at a low level, but without creating additional value with the products, the negotiation position is too weak and is exploited by buyers. Therefore, the year ended with a strong focus on ongoing projects where we believe we can build on our stronger position and offer something special to the customers. Such projects as RWA meat and processed products, Metka sausages, Tasty pork meat are, and will continue to be, our focus in the coming year.

Financial results
As mentioned before, 2016 could be divided into 2 parts. Part 1 had very good performance and results exceeded expectations in the budget. Part 2 contained some difficulties in delivering the planned contribution, mainly due to the effect of rapidly increasing pig prices. Over a few weeks, pig prices reached the level they had in mid-2014. The main determinant of prices remained high demand in foreign markets and lower supply of meat on the EU market. Finally, we ended 2016 with accumulated EBITDA of PLN 14,833 M against PLN 21,642 M the previous year. EBIT was PLN 2,701 M against PLN 10,392 M in 2015. The net result was PLN -0,315 M compared to PLN 8,940 M the previous year. EBITDA was 32% lower compared to the previous year. It is important to stress that the net result presented in the report is lower by MPLN 0,128 and the net book result is MPLN -0,187 M. The difference is related to decreasing value of deferred tax assets.

Sales
Due to a changing and turbulent market, we needed to reconsider our sales strategy, rebuild our sales department and rebuild our product portfolio. All these changes are long-term and the results of these changes were not yet visible in 2016. In 2016 we generated 8.8% less sales contribution than in 2015. Compared to 2015, we decreased MAP sales by 3.2% and increased processed sales by 17.1%. Unfortunately, both margins per kg were lower in 2016 than in 2015 (we have experienced an unexpected and rapid growth in livestock prices) and despite the fact that we have increased the margins on deboned and waste, we have not managed to surpass the previous year’s result.
In 2016 we commenced sales of RWA meat to the American market and we have been working on many projects that will play a major role in Prime Food sales in 2017 and over the coming years. We have decided to invest our time and resources in innovative projects and products and hopefully some of them will enable us to attempt to rebuild the brand and in the long term generate added value on it.

Production and investment
From an operational point of view, the year 2016 was another well-managed year with 543,980 pigs slaughtered. Daily focus on every detail allowed us to increase our yield results in all production departments. Ongoing optimization processes on various production lines focused on breakdown limitation, process streamlining and work organization. This resulted in an improvement of efficiency to 70% OEE. The good results would not have been achieved without using the Visual Management System. The focus of the entire management team in certain areas and details contributed to quality development, work safety (reduction of working accidents by 36%) and achieving a service level of 99.5% fulfilled orders. These significant operational improvements, combined with good yields, resulted in an increased of year-on-year turnover of 13% and increased processed products sales of 16.6%, and have meant that the result for the year was at an acceptable level.
Management report Danosha

Danosha continued to hold one of the leading positions among pig producing companies in Ukraine throughout 2016. The company developed production at the existing units and focused on closer cooperation with slaughter and meat processing plants. The external circumstances remained unchanged, with the conflict in the East still active and a turbulent situation in all layers of society. Nevertheless, Danosha went through the year with a constructive attitude to diverse challenges and strong positive prospects for the future.

The highlight was the ceremony of laying the first stone for a new biogas plant, which we plan to build next to the farm in Tustan village, Galych district. This will be the second such plant for Danosha and the first one in Galych district. The planned capacity is 1 MW.

Financial result

The financial result was impacted by two main factors this year. We faced the lowest meat prices in EUR ever in Danosha’s history, and at the same time experienced a significant currency loss. Despite these challenges, we consider the EBITDA result as satisfactory with UAH 304.9 m. The basis for this result was especially established by the focus on utilizing our barns in the most efficient way and a very positive year in terms of crop production. Our net result was impacted by higher depreciation costs of UAH 20 m compared to the budget. Interest costs were UAH 21 m over budget, totalling UAH 52 m, and a currency loss of UAH 82.7 m. The official currency exchange rate changed from UAH 26.22/ EUR in December 2015 to UAH 28.42/ EUR by the end of December 2016.

We ended the year with a negative net result of UAH 13.1 m, which is UAH 131.4 m below budget.

Cash flow, investments, and financing

During 2016, our cash status had a balanced tendency due to the planned investment activities and repayments of existing loans. Another aspect was the lower level of pig prices and more pigs sold. Repayments of loans and interest in the amount of UAH 306.44 m was made to creditors, namely EUR 8.99 m, USD 0.36 m and UAH 47.63 m. The total amount of purchased tangible assets was UAH 101.07 m.

Legislation

Starting from January 2016, agricultural companies were transferred into the general VAT regime with one year of a 50/50 system. The approach means that 50% of VAT calculated is returned to a special account with the possibility to purchase goods needed for production. Parliament prolonged the moratorium on agricultural land sales for another year, until 2018.

Pig production

At the beginning of the year, we decided to make some changes to the overall structure of pig production in order to ensure a more rapid reaction to challenges and to improve knowledge sharing. All three sow farms are now under one area manager, and all finisher farms are under a second area manager. This allows our area managers to focus more on production-related issues. Furthermore, just before the summer, the sales department was transferred to pig production. This helped to increase sales, which can now be executed according to requests from pig production, in order to maintain an optimal flow of weaners into the stables. Therefore, we also sold less weaners than expected, namely 2,142 fewer than budgeted.

Sow farms

It was a challenging year for all sow farms. From the beginning of summer, the sows were not milking well, weaning weight was declining and pre-weaning mortality was increasing. Many different steps were taken, and we were almost able to maintain the good production results from 2015.

Weaner farms

The result of the weaner farms was affected by the low weaning weight of piglets, so the daily weight gain was generally lower. In the fourth quarter, we could see some positive trends in the growth rates, as the piglets arrived significantly heavier at all weaner farms. All weaner farms had the same low post-weaning mor-
tality level of 1.2% for the year. The feed conversion ratio increased a little compared to the previous year, as the daily weight gain was low.

**Finisher farms**

The results on the finisher farms were generally satisfactory. The mortality rate maintained a stable level for the whole year, which was mainly due to the stable supply of feed with the correct milling. The daily weight gain was just under 1,000 grams daily, which is almost 30 grams less than in 2015. The lower energy and more sunflower in the feed was the main reason for the lower growth. This was acceptable, as sunflower was a very cheap protein source, especially after harvest.

**Arable department**

Yields were improved further compared to the previous year and we started to see positive effects from the lime spreading performed in previous years. Yields were more developed and in good condition. We had good success with the timing of growth regulator and almost every crop remained standing until harvest. Rape was strongly affected in some areas by a hailstorm in June. This caused many pods to open before harvest. Around 20% of our wheat area was slightly affected by the hailstorm. The first year with rye was successful in Luka. Rye has a stronger winter hardiness compared to other cereal crops and better flexibility. We will continue adding rye to the crop plan. The area of maize was reduced and replaced with spring barley. Logistically, this makes good sense this year and we believe we will achieve an equal profit from both crops.

<table>
<thead>
<tr>
<th>Parameter</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortality %</td>
<td>2.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Daily weight gain, gram</td>
<td>1,018</td>
<td>991</td>
</tr>
<tr>
<td>Feed conversion ratio, FU/kg</td>
<td>2.78</td>
<td>2.77</td>
</tr>
</tbody>
</table>

2016 was a year of changes at Dan-Invest and also a continuation of the political and economic course of previous years in the country. The key factors that influenced Dan-Invest in 2016 were relatively stable production at Rask farm, the first sales at DAN KUB in the first half of the year, changes to the management team and the unfortunate ASF case in Krasnodar in the second part of the year.

Fortunately, due to a huge currency gain, the net financial result for 2016 was RUB 220.7 m and this was worse than budgeted by only RUB 31.4 m (27%). Compared to the previous year, Dan-Invest showed a better net result. It is fair to say that had we not had the ASF case at the Dan KUB farm (Krasnodar), the Dan-Invest result could have been one of the best in recent years.
Pig production and feed production in Rask farm were stable and continued to improve for some of the key figures. Focus on our breeding herd, developing a strategy in collaboration with the Danish company Breeder, has improved the performance significantly. This is very clear regarding the numbers of live born. The biggest improvement took place at the finisher site, exceeding 1,000 grams daily live weight gain, and was highest in November with a 1,042 grams daily gain.

**Overview of the financial result**

Net income for Dan-Invest in 2016 was RUB 220.7 m, which is RUB 31.4 m lower than in the budget. The EBITDA ratio for 2016 was only 10.4%, which is extremely low compared to our budget (34.8%). The most significant budget/actual variations that took place in 2016 were caused by several positive and negative factors:

<table>
<thead>
<tr>
<th>Positive factors:</th>
<th>Negative factors:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency gain in the amount RUB 577.3 m that was not budgeted</td>
<td>Pig sales were less than budgeted by RUB 288.6 m (or by 15.4%). The main reasons were that we sold 6,616 heads less and the average price was less by RUB 7.2 per kg.</td>
</tr>
<tr>
<td>An ASF compensation which was booked at 173 m RUB</td>
<td>Feed costs were RUB 20.8 m over budget. A feed price which was only RUB 2.2 per kg higher than the budget gave RUB 125.6 m in ‘losses’. Due to ASF in Krasnodar, however, 7,452 tonnes of feed less were consumed and this provided savings amounting to RUB 104.7 m</td>
</tr>
<tr>
<td>Arable costs were less than budgeted by RUB 18.0 m</td>
<td>Other pig costs were RUB 67.5 m over budget (or 25.2% compared to the budget).</td>
</tr>
<tr>
<td></td>
<td>Interest costs were RUB 32.9 m or 13.7% higher than budgeted (mainly due to the</td>
</tr>
<tr>
<td></td>
<td>fact that we didn’t expect interest subsidies in Krasnodar).</td>
</tr>
</tbody>
</table>

Compared to the previous quarter, the meat-to-feed ratio in Q4 2016 increased from 6.82 in June to 7.45 in Q4 2016, equivalent to an average ratio for 2016 of 6.98. For 2015, the meat-to-feed ratio was equal to 8.89. Significantly fewer pigs were sold, as sales in Krasnodar were stopped on 28 August 2016 due to ASF. The number of pigs sold in Q4 2016 was about the same as in Q4 of 2015, when Dan-Invest did not have any sales in Krasnodar.

### Production

#### Pig production and feed production

**Rask sow section**

During 2016, most of the pig production parameters remained satisfactory, and some even improved, so we had 31.1 pigs on the old farm and 30.9 pigs on the new one in terms of the weaned/sow/year index. The farrowing rate remained at 86.3% at both farms. Pre-weaning mortality was 13.2% for the old farm, while the result on the new farm was 11.4%. As for live born pigs, there were improvements in these indexes, which were 15.85 and 15.28 on the old and new farms respectively. In general, the farm is developing in a positive direction.

**Rask weaner section**

In 2016, the daily live-weight remained constant at around 420 grams in the weaner section. The feed conversion ratio (FCR) was 2.05. In total, 150,299 pigs were produced during 2016, with a mortality rate of 2.8%. The average weight of transferred weaned pigs was 30.2 kilograms.

**Crop production**

Crop season 2016 could not be called a normal season, due to very unstable weather conditions. But this year, our crops had a good start. Only 50 ha of rye and 180 ha of winter wheat were reseeded. Spring started...
early and temperatures started to rise rapidly after the snow melted. Only 3 days later, we could supply our fields with fertilizer. We also started with spring seeding and manure application. Manure utilization set a record during 2016. 163,300 m³ (80%) was injected in the autumn. All the tests we conducted showed that there is no loss of nutrients from the manure when it is injected during the autumn. The harvest started on 26 July, a little later than normal. Generally, cereal yield was very disappointing, especially considering that we had sufficient water for higher yields. However, we can see that our newly introduced varieties are yielding much better than our old Russian varieties. The highest gains were achieved by spring wheat, with 50% more than our old variety. But we also experienced a positive trend for winter wheat.

![Fig. 47. Crop yield 2014-2015-2016](image)

Even though yields have been disappointing, we still managed to achieve a gross margin result of RUB 29.2 m (budget: RUB 6.6 m). Total revenue increased by 15.7%, and arable gross margin improved by 77.3%. Total revenue for arable production in 2016 was RUB 138.3 m, which is RUB 21.6 m better than budgeted. The key issues for this result are higher yield of winter wheat and higher sales prices for sunflower compared to the budgeted figures. Despite the fact that these are not the best results for the arable department, there are some positive elements that suggest better yields and more positive results in the future.

**Construction**

During 2016, the project and design works were completed for the new feed-mill at Rask farm. The state experts’ assessment of the project was completed and the company succeeded in obtaining permission for construction of the new feed-mill. The new credit line was successfully obtained. The construction work is proceeding according to schedule. The concreting of floors for the foundations under the silos and the main building, the installation of external networks, the installation of a transformer station, the arrangement of external lights and open wire lines were all performed during the period. SKIOLD equipment was also delivered and the specialists completed the installation. By the end of September, the infrastructure works were also completed, as well as the concreting at the feed-mill building. Sandwich panels were installed so that the building was ready by the end of the year. Installation of the drier, transport system and 4 silos was approaching completion, so that the plant can be put into operation in the first 2 months of 2017.
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