Ukraine / Electricity

Donbasenergo

Resurrection

BUY

4 July 2005 **USD 4.35**

12m Target **USD 6.00**

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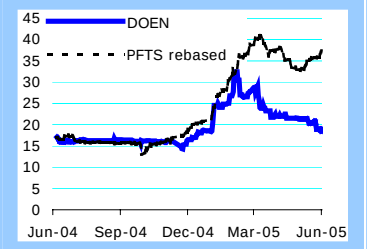
DOEN Mid-Market, UAH



Market Information	
Bloomberg	DOEN UZ
Reuters	DOEN.PFT
No of Shares, mln	**23.6**
Market price, USD	**4.35**
52Wk H/L, USD	6.4/ 2.8
MCap, USD mln	**102.7**
Free Float, %	**14.2%**

Stock Ownership	
NC ECU	85.77%
Others	14.23%

Ratios 2005E	
EBITDA Margin	15.2%
EBIT Margin	6.0%
Net Margin	1.6%
Net Debt/ Equity	0.52
Spot Exch. Rate	5.1

Donbasenergo (DOEN) has completely recovered from its debt problems and heavy losses in 2001. Thanks to the support of the EBRD and government, DOEN has completed the construction of Ukraine's first cheap and efficient energy production unit. This has ensured the company will remain competitive and continue to cut operating costs. However, DOEN's three consecutive years of poor results have caused investors to lose interest in DOEN's stock and have left the company with a poor market valuation. The company's stable output and solid prospects, combined with an unjustifiably low stock price, imply a 38% upside. BUY.

The company has recovered from its forced divestiture of three power plants, and cleared its debt accounts, allowing it to begin showing a positive net income.

The relatively low cost of electricity production makes the company competitive on the wholesale electricity market. The construction of generation units with highly efficient CFB boilers will further reduce the company's operating costs. After completing the installation and testing the boiler at one of its thermal plants, the company will implement a similar project for another plant to improve stability and decrease fuel costs. This will preserve the company's position as a low-cost producer in the mid term.

The company's positive output dynamics in recent months reflect the strong potential of one of its power plants. Moreover, the current renovation of another power plant, makes us optimistic about the demand for DOEN's electricity in the future.

DOEN's cost of capital is the lowest among thermal generators, as this is the only thermal generation company with a long-term loan refinanced by a special surcharge on its electricity tariffs. The company will receive funds for its further reconstruction projects from a similar tariff program, which will reduce its cost of capital further.

The company has restructured its current debt accounts, which protects it from the threat of bankruptcy. However, similar to other energy companies in Ukraine, DOEN's debt to fuel suppliers on the one hand and claims to electricity consumers on the other remain substantial. The company is waiting for the approval of legislation that will allow it to reconcile and write off these outstanding debts.

The company's biggest risk is increasing competitive pressure from its closest neighbor, Vostokenergo, which is the most dynamic generation company for 5M05. This also could be aggravated by increased pressure from other energy sources, such as newly constructed nuclear and hydro power plants. Increasing pressure is likely to affect the management's production plans downward.

KEY FINANCIAL DATA

	Net Rev.	EBITDA		Net Income	
		USD mln	margin	USD mln	margin
2003	202.9	3.4	2%	-32.5	-16.0%
2004	169.7	24.8	15%	0.2	0.1%
2005E	210.6	32.1	15%	3.4	1.6%

KEY RATIOS

	P/S	P/E	EV/ EBITDA
2003	0.49	Neg.	51.97
2004	0.59	544	7.51
2005E	0.48	28	5.31

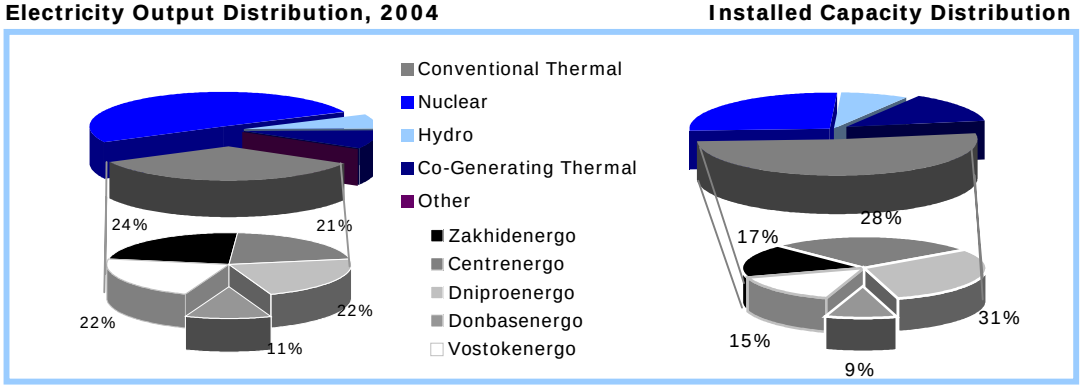
Content

History & Dynamics

After being forced to divest three power plants, DOEN became Ukraine's fifth largest GenCo.

Donbasenergo (DOEN) is the fifth largest thermal generation company in Ukraine in terms of installed capacity and output (2004). In 2001, the company controlled five thermal power plants (TPPs) in eastern Ukraine, the country's most intensive energy consuming region. In 2001, during the company's bankruptcy process, three out of five TPPs were sold to pay off debts. Since March 2002, these three TPPs have been operated by Vostokenergo (VSEN), DOEN's main competitor in the region. Now DOEN operates the Slaviansk and Starobeshev TPPs, with a total installed capacity of 2.66 GW. The company generated 6.75 TWh of electricity in 2004, which is 3.7% of Ukraine's total production.

Electricity Output Distribution, 2004 **Installed Capacity Distribution**

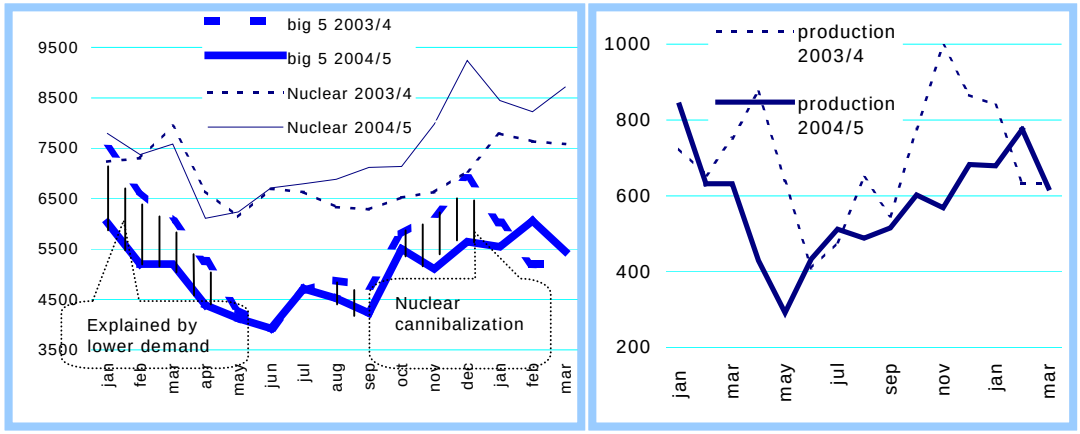


Source: EnergoBusiness

DOEN decreased output by 19% in 2004, mainly because of nuclear cannibalization

DOEN's output and revenue decreased by 19% and 16% respectively in 2004. This decline was caused by low demand for electricity on the domestic market in spring 2004, and nuclear cannibalization in the fall of 2004: two nuclear energy units were installed in 2004, one (1GW) in August, and another (1GW) in October. This increased total installed generation capacity in Ukraine by 4%, and negatively affected thermal output.

Ukraine's Electricity Output 2004/5 Vs. 2003/4, TWh Output By DOEN, TWh



Source: EnergoBusiness, Concorde Capital estimates

DOEN's production trend followed the same pattern as total thermal output. DOEN significantly underperformed in 2005 compared to the previous year. This was especially so in the spring, when demand for thermal power is generally lower, due to higher utilization of hydro power, and also in the fall, due to nuclear cannibalization.

Output growth is expected in 2005

Despite a decline in 2004 production, DOEN's management is positive about the company's output growth in 2005. The main reasons for this are the stabilization of nuclear capacity use (currently, nuclear power plants have to limit their number of working units, due to excess capacity supply), and DOEN's expected growth in capacity utilization due to its ability to supply relatively cheap electricity.

What Factors Determine DOEN's Market Position?

1. TPP sector utilization
2. DOEN's competitiveness relative to other TPPs

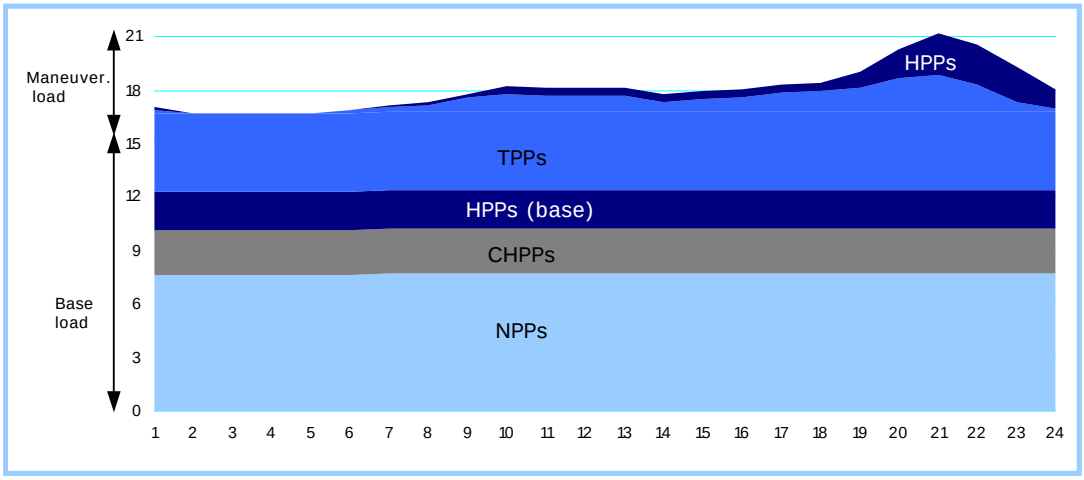
There are two key factors for DOEN's market position and its sustainability. First is the space left for thermal power plants in the Ukrainian electricity sector. TPPs are utilized after nuclear PPs, combined heat and power plants, and in some cases, hydro PPs are utilized. Second is DOEN's competitiveness relative to other thermal companies. The position a TPP holds in the wholesale market is dependent on its ability to produce electricity at a cheaper price than its competitors.

The GenCo Market Position

Thermal electricity generators (GenCos) are suppliers of maneuverable (changeable) capacity, together with Hydro PPs. In the base load capacity supply segment, the main competitors to TPPs are Nuclear PPs.

Daily Change In Generation Capacity, GW

TPP supply base load and changeable capacity

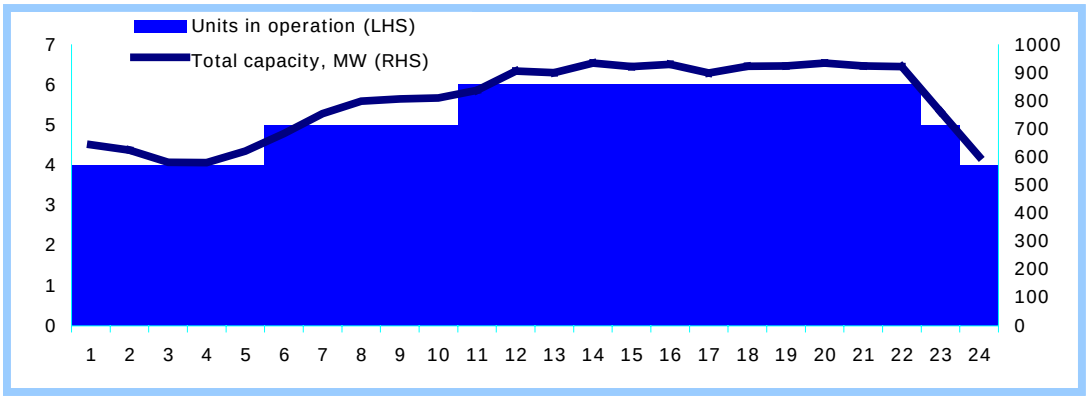


Source: Energy Policy of Ukraine

Due to the flexibility of thermal units, they are often used in the maneuverable mode

The maneuverability of TPPs means that they can significantly change their total capacity within one day, altering the number of working generating units, and changing the working capacity of the units. Below is a schedule of hourly operations by DOEN's Starobeshev TPP on December 2, 2003.

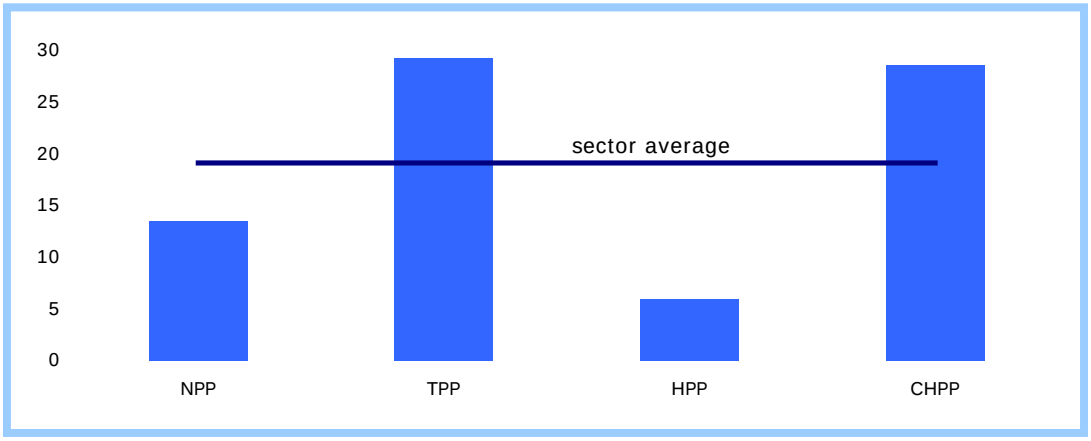
December 2, 2003: Hourly Schedule of Starobeshev TPP Units



Source: Energy Policy Of Ukraine, Concorde Capital estimates

The high cost of thermal electricity production, compared to alternative electricity sources, is the main reason for the low utilization of thermal capacities. The wholesale market operator, which is also the sector dispatcher, has an incentive to utilize more nuclear and hydro capacity than thermal power plants, in order to lower electricity payments.

Average 4m05 Wholesale Electricity Price, USD/MWh



Source: Energorynok, Concorde Capital calculations

Base Load Segment

Base load capacity is capacity that does not change during the day. The base load segment's main suppliers are nuclear power plants (as they cannot change their capacity by more than 1-2%, and cannot stop and start within a limited period of time), combined heat and power plants (their electricity supply depends only on heat supply needs), and thermal power plants (thermal units that work at minimum levels, and non-maneuverable, large capacity units). In the flood period, during April-May, hydro power plants need to work around the clock to reduce water levels in the rivers, and therefore they also supply base load capacity.

The lower base load utilization limit for a TPP depends on its maneuverable capacity needs and plant specifics

The base load capacity of TPPs is bound from the bottom by the maneuverability of TPP capacity (i.e. there is a minimum amount of maneuverable thermal capacity needs, and TPPs working for the base load cannot be less than the amount that is guaranteed to cover the maneuverable load). Also, a TPP cannot work on the level below that which guarantees stable work of the power plant (on average, at least two power units work in each power plant to guarantee the safe operation of the TPP). In fact, TPPs are working at their bottom limit level in times of low electricity demand, in the summer period.

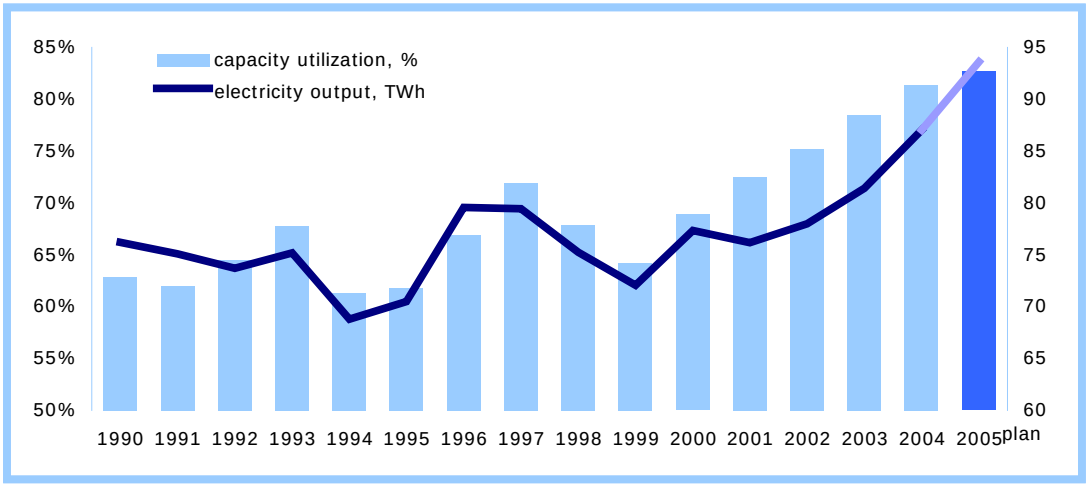
The upper limit for TPP utilization depends on the residual capacity utilization needs at NPPs

Technically feasible top limit of TPPs utilization is not reached in Ukraine, as Ukraine has excess capacity supply. Top limit is defined by the scope of base load supply of cheaper power sources: NPPs and CHPPs, and by the aggregate electricity demand in the network. With commissioning of new nuclear capacities in Ukraine, nuclear power plants are expected to narrow the top limit of TPPs usage. Potentially, NPPs can limit the scope of TPPs usage to their lower bound.

The output growth at NPPs in 2005 is unlikely to affect thermal power generators

In 2004, Ukrainian nuclear power plants reached a historical level of output and capacity, which caused a 13% yoy decrease in thermal output in 2H04. Energoatom's plan for 2005 goes further with an increase of electricity supply by 6.1 TWh. However, this growth in output will be consumed by Russia, as Energoatom will export 6 TWh there. Thus, nuclear expansion is not expected to affect output by other generators in 2005, and we should not expect further cannibalization of thermal output by nuclear plants, at least in 2005-1H06.

UA Nuclear Power Plant Dynamics



Source: Energoatom

The Maneuverable Market Segment

HPPs are a cheaper alternative to TPPs' maneuverable capacity…

Like TPPs, hydro power plants can be used in any mode: stable (base-load) or changeable. Therefore, hydro power plants can substitute for TPPs in all aspects. The use of hydro plants may also be encouraged, as they are much cheaper than TPPs. However, the low capacity of HPPs in Ukraine means it is more efficient to use them for network regulation purposes (i.e. in changeable mode). As HPPs are mainly utilized in maneuverable capacity mode, they compete with TPPs in this business segment. The only drawback to HPPs compared to TPPs, is their dependence on weather conditions, and water levels. Therefore, HPPs have a lower ability to secure a safety reserve in emergency situations. This drawback draws the reliability of using hydro power plants instead of thermal power plants into question.

… but hydro power is a less reliable source of energy than thermal

Growing Hydro Power Supply

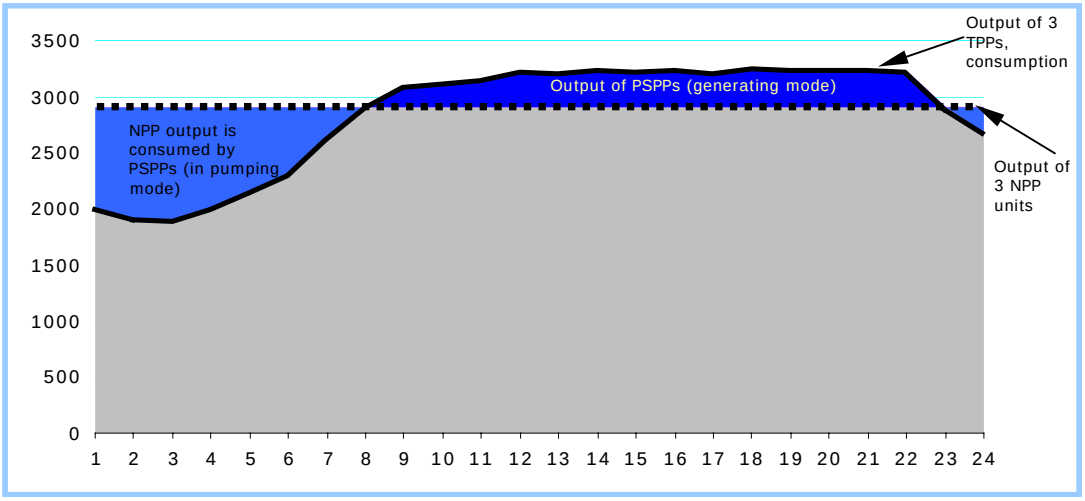
In 2005-2006, two hydro pump storage plants (PSPPs) are to be commissioned with a total installed capacity of 1.2 GW (300 MW at the Tashlyk PSPP on the Pivdenniy Buh River, and 900 MW at Dnister PSPP on Dnister River). Pump storage plants are cyclical hydro power plants which consume electricity in pump mode to fill their upper reservoir in times of low electricity demand, and generate electricity in times of high electricity demand, draining the upper reservoir.

Installation of PSPPs is the greatest threat to TPPs, as they lower the demand for TPPs' maneuverable capacity. This will in turn reduce the lower limit for TPP usage in the base load segment. While this will allow for higher utilization of cheaper nuclear capacity, it will significantly decrease thermal capacity utilization.

TPPs will likely be utilized less in maneuverable mode, after PSPPs have been commissioned

PSPPs are expected to work in a reserve (not operating) mode in the summer period, due to low demand for electricity and possible water shortages in the dry period. In periods of high electricity demand, such as the winter, PSPPs will work to smooth out the demand/supply balance of electricity capacity, i.e. they can partially substitute TPPs' maneuverable units, and reduce demand for the thermal maneuverable load. One possible outcome is that PSPPs will work together with NPPs to substitute thermal capacity. This scenario is depicted in the following chart.

TPPs vs. NPPs & PSPPs: Can they be substituted for one another?



Source: Energy Policy of Ukraine, Concorde Capital

The solid black line represents ouptut at three Ukrainian TPPs: DOEN's Starobeshev TPP, Vostokenergo's Kurakhov TPP and Centerenergo's Zmiiv TPP on December 2, 2003. Their total working capacity changes from 1,900 MW at night to 3,200 MW in the evening. However, three NPP units (3x1000 MW) and new PSPP units (1,200 MW) can supply capacity in the same pattern. To do this, the NPP units must work in stable 2,920 MW mode, while PSPPs work in pumping mode at night, consuming excess capacity. They work in generation mode during daytime hours, generating electrcity from the accumulated water**.** Note that taking into account the low cost of hydro and nuclear electricity production, the NPP and PSPP system is much cheaper than the system of three TPPs. The only drawback to the cheap system is that it needs to consume much more electricity, but with excess capacities, higher capacity utilization is beneficial in Ukraine now.

Water shortages in Pivdennyi Buh can limit potential operating capacity at the Tashlyk PSPP

Thus, the position of thermal power plants may be weakened after the PSPPs projects in Ukraine have been completed. However, in reality the operation of new hydro capacities will be restricted by environmental conditions. Hydro power plants depend on their water supplies, and HPPs can only operate within the limits of water regulations. In particular, Tashlyk PSPP will demand additional usage of about 2 mln of cubic meters of water p.a., which is nearly impossible without disturbing the Pivdenniy Buh River water reserves. This PSP will be able to work at full capacity only in periods of sufficient water supply.

Dnister PSPP construction could be postponed due to political uncertainties

Commissioning the Dnister PSPP in 2006 may be postponed, because of Ukraine's problems with neighboring Moldova, which claims it owns part of the territory on which some of the Dnister PSPP's equipment is located.

Conventional thermal power is important in Ukraine's energy independence program

In addition, thermal power is the most stable source of energy in Ukraine and the sector is closely related to the coal industry. Taking into account that Ukraine has rich coal deposits, but imports all its nuclear fuel from abroad, the survival of the thermal power plants will guarantee Ukraine's energy independence. Ukrainian Prime Minister Yulia Tymoshenko has voiced her concerns in this area and has strongly urged the development of the coal sector, and has stressed that thermal electricity is necessary to ensure demand for energy coal, and a stable electricity supply.

Another important argument for thermal capacity is the relatively low cost of TPP construction and decommissioning compared to NPPs, and the absence of fuel waste recycling problems.

A new electricity strategy will be adopted, placing priorities on developing different sources of energy

A new strategy for electricity sector development will be adopted in July-August, which will allow us to more accurately predict developments in the nuclear and thermal power sectors. The least desirable strategy for TPPs is the possible construction of 11 nuclear power plants capable of generating 1 GW each by 2030 which is being considered. This could weaken the position of TPPs compared to the previous draft strategy which only envisioned the construction of 5 new NPPs. However, even under a scenario calling for the greatest number of nuclear power plants, plenty of room will be left for thermal power plants. From 2011 to 2019, 11.8 GW of nuclear capacity will complete its 30-year working reserve in Ukraine. If we take into account the French experience of prolonging nuclear capacity life to 40 years, Ukraine may postpone the problem of decommissioning 11.8 GW of old nuclear capacity and building new units until the mid 2020s. Regardless, even the "nuclear" scenario foresees the only installation of 11 GW of new capacity, instead of 11.8 GW which will be decommissioned by that period.

Under all possible energy strategy scenarios, the supply of nuclear power in Ukraine will be reduced by 2030…

Taking into account an estimated CAGR of 2.5% for domestic energy demand, and a decrease in long-term nuclear power supply, even under the "nuclear scenario", thermal capacities will remain a key power source.

… convincing us that the thermal sector has a certain future

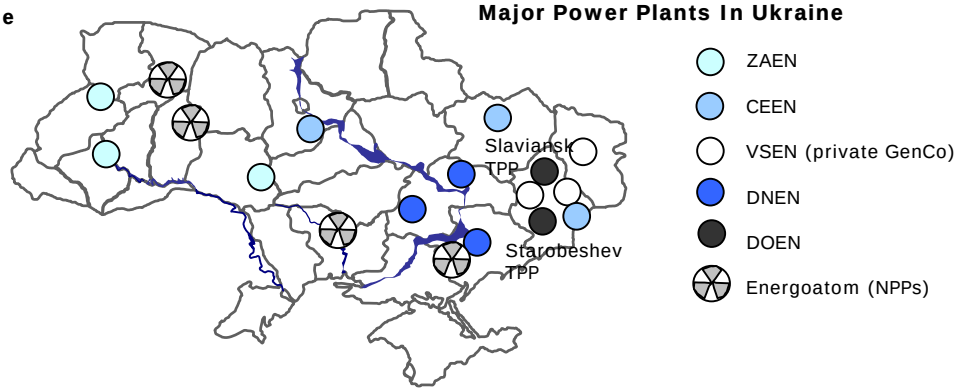
We remain optimistic about the future of thermal power in Ukraine, as the best guarantee to support the energy balance and energy independence. An increase in generation capacity (PSPPs) may be consumed by external demand. Ukrainian energy is already being exported to Russia and Moldova, and from a separate network, to the European network, UCTE. Further, it will be exported to Belarus in 2006 (2.6 TWh p.a.), and possibly to Georgia in the future. It is also possible that Ukrainian electricity will be supplied to EU/UCTE countries, as has been done in western Ukraine from the Burshtyn and Dobrotvir TPPs. We predict thermal output will increase by 2-3% in 2005, remaining close to 2005 levels within the next three years, with a possible increase by 2-3% afterwards.

DOEN's Position Compared To Other GenCos

Both DOEN's power plants are located in the region with the highest concentration of thermal power plants. Thus, the company experiences the highest competitive pressure among state-owned GenCos.

DOEN's TPPs have the largest number of local competitors

Major Power Plants In Ukraine



Competition in the conventional thermal segment in Ukraine is tough

Like all the thermal generation companies in Ukraine, DOEN's power plants take part in the capacity tender process. This tender selects the cheapest and most maneuverable thermal power units for work. More expensive and less maneuverable units have a poor chance of selling their electricity to the wholesale market. Power plants that supply expensive electricity or non-maneuverable capacity can only work at minimum maintenance levels.

Unlike other TPPs, one TPP unit at Slaviansk cannot be stopped by the dispatcher …

… but this unit is still utilized in the least suitable way

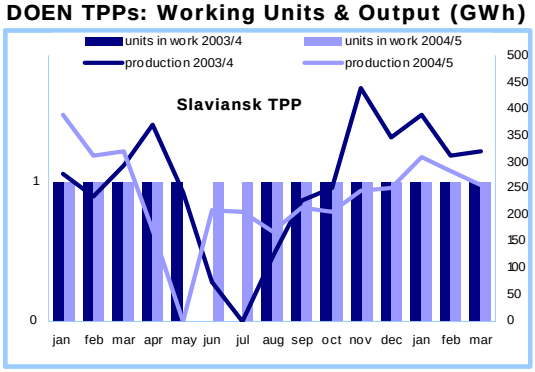
DOEN's Slaviansk TPP has only one unit (800 MW), and it cannot be stopped if the plant is to remain functional. Thus, this unit cannot be stopped by the dispatcher, regardless of the quality or price of electricity. This power unit only stops working for a few weeks in the summer, when it must be shut down for maintenance. The unit has a double boiler, which can work at a capacity of 320-400 MW (in single boiler mode) and at 700-750 MW. This unit usually works in single boiler mode, maintaining a reserve of about 350 MW, however, it is possible for it to work in double boiler mode, and supply an additional 350 MW at any given time. Slaviansk TPP's unit, which is coal-fueled (as opposed to expensive gas) can remain in operation for a long period. This is the only 800 MW unit now working in Ukraine, and the only coal-fueled unit with such a significant capacity.

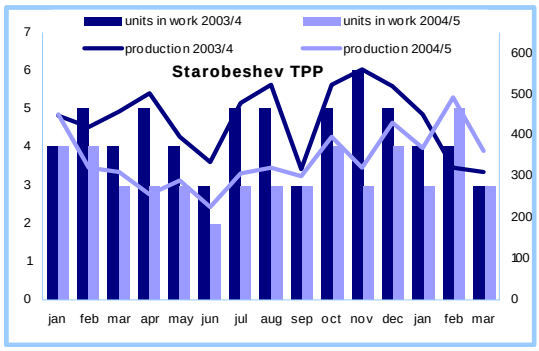
The fact that the Slaviansk unit is utilized mostly in one-boiler mode negatively affects its utilization.

DOEN's Starobeshev TPP is utilized less, on average

The Starobeshev TPP has 10 units of 175 MW each, and is utilized less intensively than Slaviansk. For most of last year, only three units of this TPP were active. As the units are highly maneuverable, they are utilized in maneuverable mode during the winter period (refer to chart on page 4). However, these units are utilized less in summer, when maneuverable demand is much lower.

DOEN TPPs: Working Units & Output (GWh)

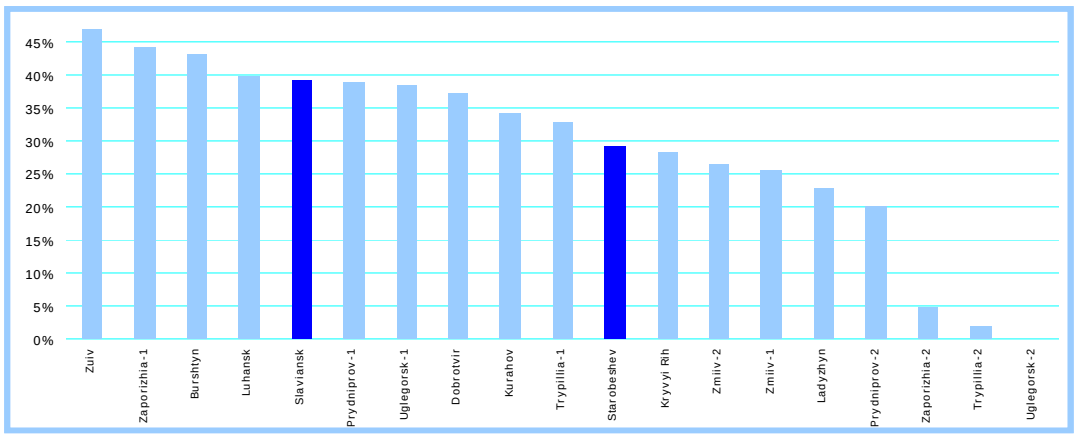




Source: EnergoBusiness, Energorynok, Concorde Capital calculations

In terms of capacity utilization, power plants at DOEN are ranked in the middle of Ukrainian TPP universe, with Starobeshev TPP positioned below the median capacity utilization. The situation with Starobeshev's utilization will improve in 2005, because this plant is the first in Ukraine with a cheap and efficient unit that works according to CFB technology.

TPPs Capacity Utilization Ranking, 2004

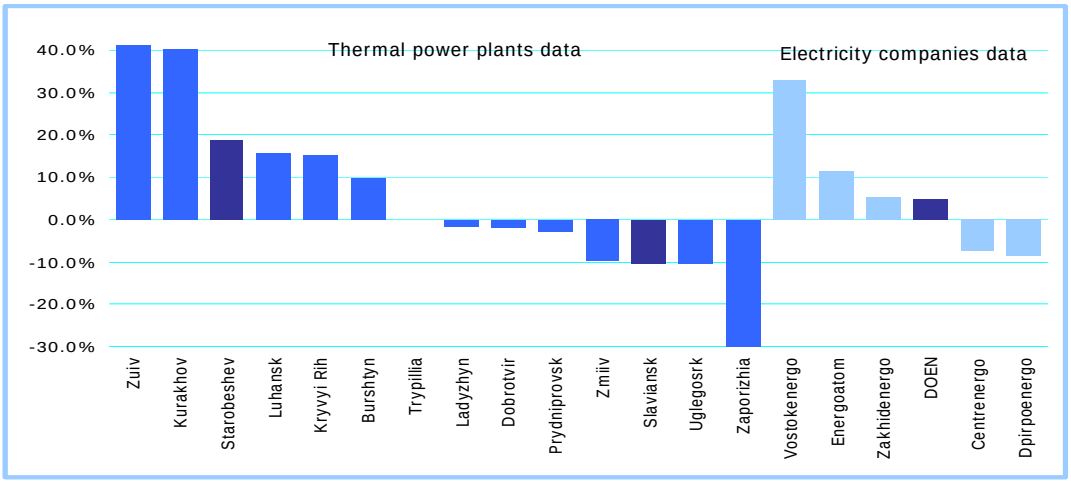


Source: EnergoBusiness, Concorde Capital calculations

Vostokenergo's vertical integration synergies make it DOEN's most powerful rival in the local energy market

DOEN's main competitor is Vostokenergo (VSEN), which operates three TPPs that were taken from DOEN as part of a bankruptcy procedure in 2001. Since mid 2004, VSEN has become part of the Donbass Fuel and Energy Company, a vertically integrated private company, which also contains two large coal mines with enough coal to meet all VSEN's fuel needs. The Donbass Fuel and Energy Company also controls energy distribution companies in the Donetsk and Dnipropetrovsk regions. In 4M05, VSEN showed surprising electricity production dynamics, leaving behind even Energoatom (NPPs).

Output Change, 4M05 yoy



Source: EnergoBusiness, Concorde Capital calculations

DOEN's recent positive dynamics makes us more optimistic about their management's plans for 13% growth in 2005…

The fact that DOEN had positive dynamics in 2005 demonstrates the company's competitiveness in the Donbass energy market, and suggests we can rely on their management's positive output forecast in 2005. We expect a further decrease of utilization of the Slaviansk TPP, with more usage of the plant's unit in single-boiler mode, but an increase of utilization of Starobeshev TPP's units.

… but pressure from VSEN could spoil these plans

We also expect the potential cannibalization of DOEN's market share by its powerful competitor, VSEN. Thus, we forecast 13.5% electricity output growth, against management's 16.4% plan.

Reconstruction & The New Technology Advantage

DOEN possesses a uniquely efficient boiler…

Since February 2005, tests of newly constructed unit with a circulated fluidized bed (CFB) boiler have taken place at the Starobeshev TPP. The CFB boiler will allow the TPP to burn of coal mining waste or waste coal that has already been burnt at thermal power plants with traditional technology. New technology will allow not only for the usage of cheap fuel, but also improves the efficiency of fuel burning at the unit #4 to about 50-60%, compared with a current rate of 28-35% in Ukraine. This also implies a lower level of emitted pollutants.

The reconstruction of Starobeshev's unit #4 with CFB technology began in 2002 and was carried out by the German company Lurgi Lentjes AG. The cost of the project was about EUR 124 mln, including a EUR 91 mln EBRD loan. The loan was refunded by a special investment surcharge on DOEN's electricity tariff, as set by the regulator. This makes EBRD loans cheap (or free) for DOEN. In fact, all the repayments on the loan and interest are provided from the predetermined surcharge to DOEN's electricity tariff. DOEN's costs on the loan relate only to UAH depreciation, as the loan is nominated in EUR. As a result of EUR appreciation, DOEN lost USD 3.82 mln in 2004. This year the company is expected to obtain about USD 2.5 mln in additional income from UAH appreciation.

Testing unit #4 is expected to be finished by September, when it will be ready to consume sludge.

A new unit with a CFB boiler will be constructed by DOEN by 2010

As the Starobeshev TPP is the first to utilize such technology in Ukraine, this power plant will have a significant advantage to other TPPs in supplying cheap electricity to the wholesale market. By 2010, similar technology will be implemented at four TPPs at other GenCos, and one unit with a CFB boiler will be built at the DOEN's Slaviansk TPP. According to the state program for TPP renovation, a 100 MW unit with a CFB boiler is to be constructed at the Slaviansk TPP by 2010. DOEN's management expects to construct a 125 MW unit there. DOEN's plans to build a unit at Slaviansk TPP have already been approved by the state committee for investment project control. Specialists in DOEN declared they could construct a boiler by themselves, which will save about 50% on the boiler's purchase costs.

DOEN will remain the GenCo with low cost of capital

During 2005-2010, DOEN expects to obtain an additional USD 126 mln in surcharge support from the new state program for thermal electricity development. A new surcharge project, combined with the EBRD project, will give DOEN one of the highest state support levels for reconstruction per kW of installed capacity in 2002-2010, which is close to 85 USD/kW. Like the 2002 surcharge program, the new surcharge program will continue to result in a low cost of capital for DOEN.

Investment Surcharge 2004-2010, USD mln

	Total	Total, USD/kW	2004-5	2006-7	2008-10
DNEN	149	18	8	29	112
ZAEN	310	66	9	147	154
CEEN	496	66	18	138	340
VSEN	359	88	24	90	245
DOEN	126	47	14	32	80

Source: Cabinet of Minister's Decree #648-R (2004)

DOEN Investment Surcharge Targets, USD mln

Unit	Capacity	Surcharge Revenues		
	MW	2004-5	2006-7	2008-10
Starobeshev #5	200		16	
Starobeshev #11	200			16
Starobeshev #13	200			24
Slaviansk #3	125	6	16	40
Slaviansk #7	720	8		

Currently, the unit #7 at the Slaviansk TPP has been stopped for minor repairs. The company expects to receive about USD 8 mln (according to the investment surcharge program) to cover the costs of this repair. This will improve stability at the only working unit of the Slaviansk TPP, reducing the possibility of emergency situations and an extraordinary decrease in output.

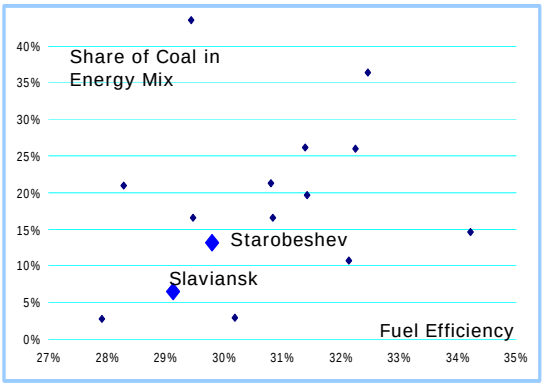
Fuel & Cost Efficiency

The low utilization of gas in the production process negatively affects DOEN's fuel efficiency…

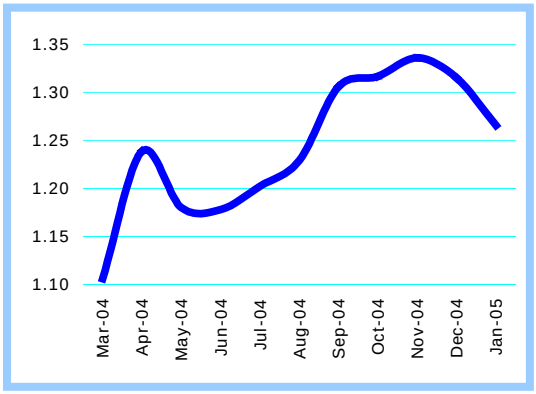
DOEN's TPPs show one of the lowest level of fuel efficiency in Ukraine, mainly due to the low usage of gas in its fuel mix. Since 2004, gas has become a more expensive energy unit than coal, and the low utilization of gas in electricity production has given the company lower fuel costs.

… but due to differences in gas and coal prices, cost efficiency at DOEN has remained low

Fuel Efficiency vs % of Coal Usage, 2004



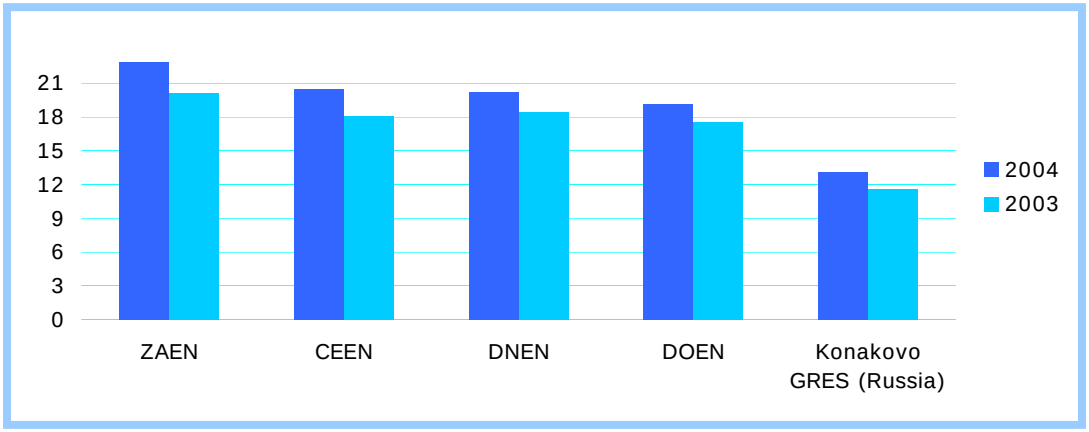
Ratio Of Gas To Coal Prices*



Source: EnergoBusiness, Fuel And Energy Ministry, Concorde Capital estimates
**Ratio of USD- per-unit prices for energy contained in each fuel*

In terms of operating costs per MWh of electricity produced, DOEN is a leader among state controlled GenCos, while it still lags behind Russian TPPs which consume cheap gas.

COGS per MWh, USD



Source: company data, Concorde Capital calculations

A location close to coal deposits allows the company to economize on transportation costs

The low cost of electricity production is explained by the high quality of supplied coal (lower utilization of gas), and lower coal costs compared to GenCos with TPPs located in central and western Ukraine. TPPs at DOEN have advantages over other state-controlled GenCos' power plants, as they are located in regions with rich coal deposits, implying low transportation costs. Note that the distance between TPPs of GenCos to the Donets coal deposit is directly related to company COGS per MWh.

In late 2004, the government announced a blueprint for the Energy Coal Market, with an equal coal price and transportation costs for all GenCos in Ukraine. If the plan start working, DOEN's cost advantage may decrease. However, we do not believe that making transportation costs equal for all the TPPs is reasonable, and therefore doubt that it will happen.

When installation of CFB boiler at Starobeshev's unit #4 will be completed, efficiency at the TPP is expected to increase by 5-8% and DOEN's COGS per MWh may decrease by 1.5-2.5%.

Financial Stability

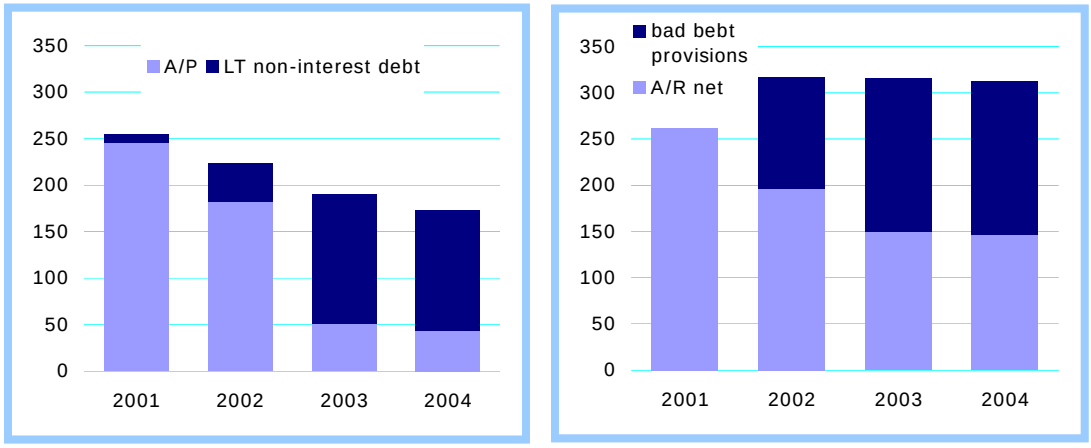
In the mid 1990s, the Ukrainian electricity sector was characterized by low payment discipline, which raised GenCos accounts receivable due to payment arrears from the Wholesale Energy Operator, and raised accumulated payables to fuel suppliers because of capital deficit. As a result of this debt accumulation, GenCos faced the threat of bankruptcy, with creditor claims on one hand, and the impossibility of obtaining payments from the powerful wholesale operator on the other.

In 2001, DOEN went bankrupt, which resulted in the sale of three power plants for USD 38 mln (or USD 9.4 per kW of installed capacity), significantly lower than their book value of USD 118 mln. This sale did not solve the company's debt problem, and worsened DOEN's low profitability. The company has lost 55% of its fixed assets, and was left with USD 246 mln in accounts payable and USD 291 mln in accounts receivable. Debts for the fuel supply of the TPPs sold also remained on DOEN's accounts. Net losses totaled 33.7 mln in 2001, as a result of the TPP divestiture.

Fixed asset loss and debt optimization process of 2001-2003 spoiled DOEN's image

Further, in 2002-2003 DOEN decided to clear its current debt accounts. During these years, USD 163 mln in receivables was transferred to bad debt provisions, which resulted in a net loss of USD 76 mln in 2002, and USD 26 mln in 2003. As a result, DOEN gained the reputation of a company on its death bed.

DOEN's Debt Accounts Dynamics, USD mln



Source: company data

Now the company is positioned more attractively than DNEN and CEEN

From 2002 to 2003, accounts payable were restructured: A/P was reduced by USD 195 mln due to the redemption of USD 59 mln, and re-classification of USD 136 mln into long-term non-interest bearing liabilities. This allowed the company to secure itself from filing for bankruptcy, giving it a better position than Centrenergo (CEEN) and Dniproenergo (DNEN). In addition, DOEN's debt management policy looks more transparent than that of the latter two GenCos. Still, DOEN has the highest proportion of adjusted debt (accounts payable and long-term non-interest bearing liabilities) to sales among all the GenCos.

GenCo Debt Accounts, Jan 1 2005

	A/P	A/P + [Long-term non interest bearing liab.]		A/R
	USD mln	USD mln	% to sales	USD mln
DOEN	44	174	103%	150
CEEN	196	294	96%	324
DNEN	247	271	83%	118
ZAEN	42	139	38%	122

Source: company data

DOEN is looking forward to the adoption of a new law, which will allow it to reconcile its debts with its outstanding receivables. A draft law was passed in its first reading one and half years ago, but it still has not been passed in a final reading.

We expect net income growth in the future

After series of highly unprofitable years, DOEN finished 2004 with a positive net income. Payment discipline increased almost to 100%, and nearly all DOEN's bad receivables have been written off, so we expect the company's net income will increase in the future.

The company has implemented a policy of asset liquidation by selling the additional assets left behind by the TPPs it sold, releasing itself from the related social obligations. This process allowed the company to decrease social burden by USD 1.8 mln during the last two years. Still, expenditures for social payments remained USD 5.4 mln in 2004 and they are unlikely to reduce further.

Valuation: Peer Comparison

Ukrainian Peers

Ukrainian GenCos are the closest peers to DOEN, due to similarity in origins and in their environment of operation. CEEN and DNEN are the most comparable companies, as they work in the same competitive environment as DOEN, while ZAEN with its export advantages can be less comparable.

DOEN & Ukrainian GenCos

	Sales USD mn 2004	Fuel Efficiency 2004	Cap. Utilization 2004	MCap USD mn	P/S	EV/S	P/Capacity USD/kW	EV/Capacity USD/kW	P/Prod USD/MWh	EV/Prod USD/MWh	EV/EBITDA 2005E
CEEN	308.7	31.8%	18.8%	292.6	0.95	1.32	38.8	54.2	18.2	25.4	7.0
DNEN	328.1	33.2%	18.2%	242.5	0.74	1.03	29.7	41.5	15.8	22.0	5.2
ZAEN	368.5	30.3%	32.9%	328.3	0.89	1.04	69.7	81.2	25.0	29.1	10.0
Average		**31.8%**	**23.3%**		**0.86**	**1.13**	**46.1**	**59.0**	**19.6**	**25.5**	**7.4**
DOEN	170.0	30%	31%	103.0	0.61	1.15	40.4	73.1	15.2	28.8	5.3
Implied Upside					42%	6%	14%	-35%	29%	-11%	38%
Implied Target, USD					6.2	4.59	5.0	2.8	5.6	3.9	6.0

Source: Company Data, EnergoBusiness, Concorde Capital estimates

Being more utilized than its Ukrainian peers on average, the company suffers from the worst fuel efficiency. The latter is expected to improve in 2005, at least to the level of its peers, as a unit with advanced burning technology is commissioned.

We present multiples based on both market capitalization and enterprise value, as DOEN has received a loan from an international financial institution which formally increases its EV, but *de facto* the company does not carry the burden: DOEN is the only GenCo with interest and principal of the loan being repaid from the special surcharge to the company tariff.

Taking into account all the items mentioned above, we value DOEN higher than CEEN and DNEN, but lower than ZAEN.

Closest International Peers

DOEN's thermal power plants are similar in profile and history to Russian TPPs, particularly those at Cherepets, Konakovo, Kostroma and Stavropol. All the listed Russian TPPs were built according to Soviet technology and are located in industrial regions in the European part of Russia.

DOEN vs Russian Peers (2004 data)

	Utilization	Efficiency	Output TWh	Capacity GW	MCap USD mn	Main Fuel	Sales USD mn	EBITDA margin
Cherepets GRES	19%	29%	2.4	1.43	58	coal	64	n/a
Stavropol GRES	44%	37%	9.4	2.4	223	gas	135	14.0%*
Konakovo GRES	30%	37%	6.3	2.4	239	gas	137	17.6%*
Kostroma GRES	58%	40%	12.0	3.6	410	gas	199	9.2%
DOEN	31%	30%	6.8	2.55	103	coal	170	14.6%

Source: company data, Concorde Capital estimates, RTS
**Data for 2003*

The closest peer is Cherepets GRES, which like DOEN's TPPs, also consumes coal. Compared to the Cherepets GRES, DOEN produces cheaper electricity (24.2 USD/MWh vs. 29.8 USD/MWh), and is more heavily utilized. Therefore, DOEN deserves higher valuations than this Russian TPP.

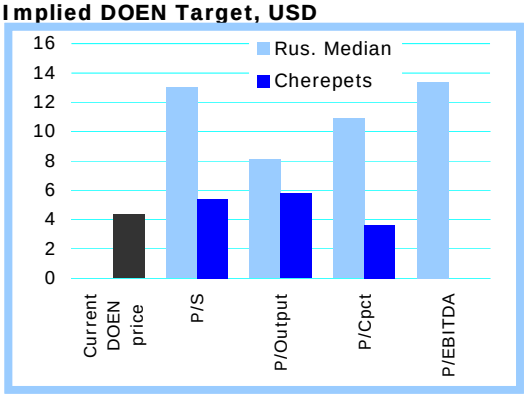
The other Russian TPPs utilize gas as their primary fuel (which is much cheaper in Russia), their capacity is more heavily utilized and they are more fuel efficient compared to DOEN. However, profitability at all Russian peers is comparable to DOEN.

Multiples Comparison

	P/S	P/Output USD/MWh	P/Cpct USD/kW	P/EBITDA
Cherepets	0.7	19.4	32.1	n/a
Stavropol	1.5	21.9	85.4	10.8
Konakovo	2.2	46.7	122.9	12.2
Kostroma	1.9	32.5	107.8	21.1
Russian Median	**1.7**	**27.2**	**96.6**	**12.2**
DOEN	0.6	15.2	40.4	5.3
Implied Upside				
@ Median	184%	79%	139%	131%
@ Cherepets	18%	28%	-20%	n/a

Source: company data, Concorde Capital estimates, RTS

Implied DOEN Target, USD



All Russian TPPs are valued by the market higher than DOEN. Even when compared to the Cherepets TPP, which has shown worse results than DOEN, upside is implied.

Though we have done everything possible to ensure the accuracy of Ukrainian financial data, we cannot vouch for the accuracy of Russian data. Thus in valuing DOEN in relation to its Russian peers, we have relied more on comparisons of its P/Output and P/Capacity.

Global Peers

A global peer comparison also suggests that DOEN has significant upside potential, while only an EV/EBITDA ratio suggests a discount.

DOEN vs Developed & Developing Markets Peers

Company	Country	EV/S	P/Prod. USD/MWh	EV/Prod. USD/MWh	P/Cpct USD/kW	EV/Cpct USD/kW	EV/ EBITDA 04	EV/ EBITDA 05
Western Europe								
Enel	IT	2.05	454	694	1264	1934	6.70	6.38
RWE	DE	1.11	176	271	763	1175	4.63	4.32
Vattenfall	DE	0.84	84	95	223	252	4.89	n/a
EnBW	DE	1.30	76	115	635	958	5.36	4.66
Endesa	ES	1.56	143	216	547	825	n/a	n/a
China								
Beijing Jingneng	CH	2.18	n/a	n/a	n/a	n/a	6.87	n/a
Chongqing Three	CH	1.92	n/a	n/a	n/a	n/a	8.64	n/a
Shenzhen Nanshan	CH	2.79	n/a	n/a	n/a	n/a	10.43	n/a
Hunan Huayin	CH	2.28	n/a	n/a	n/a	n/a	10.42	n/a
Huadian Power	CH	2.30	n/a	n/a	n/a	n/a	6.53	n/a
Central & Eastern Europe								
CEZ	CZ	3.50	146	171	732	856	9.92	n/a
Mosenergo	RU	1.19	31	36	162	185	7.11	n/a
Lenenergo	RU	0.58	30	38	123	155	n/a	n/a
Bedzin CHPP	PL	1.22	68	96	324	457	6.69	n/a
Cogeneracia CHPP	PL	1.61	n/a	n/a	303	560	11.63	n/a
Median		1.61	84	115	324	508	6.87	4.66
Mean		1.76	134	192	423	531	7.68	5.12
DOEN	**UA**	**1.15**	**15**	**29**	**40**	**73**	**7.51**	**5.34**
Implied Upside								
@ median		85%	452%	571%	702%	1079%	-12%	-24%
@ average		109%	784%	1082%	948%	1136%	9%	-4%
Implied Target, USD								
@ median		7.7	23.0	27.9	33.4	49.1	3.7	3.2
@ average		8.7	36.8	49.2	43.6	51.4	4.5	4.0

Source: Bloomberg, I/B/E/S, company data, Concorde Capital estimates

In comparison to its international peers, we have focused on EV/S and EV/EBITDA ratios, as a comparison of technical parameters would be less reasonable for companies from different countries and using different technologies.

DCF Valuation

WACC Calculation	
Debt/Equity	0.485
Share of zero cost equity	0.050
Weight of debt	0.245
Weight of equity	0.640
Avg. Interest Rate	**5.2%**
Ukr Eurobonds YTM	6.0%
Corp. bond premium	8.5%
Equity premium	5.5%
Company-specific Prem/Disct	0.3%
Cost Of Equity	**20.3%**
WACC	**14.3%**

Company Specific Risk Breakdown:	
Corporate Governance	0.0%
Management Aptitude	0.0%
Financial Stability	0.3%
Total	**0.3%**

This model is built on the assumption that DOEN's electricity output will grow by 13.5% in 2005 (contrary to the management's plans of 16%), and by 4.5% in the next year. Further output will grow at 2.1% CAGR. The company's growth to perpetuity is set at 2%.

DOEN's CapEx program until 2010 will be funded by an investment surcharge by 46%. The surcharge on electricity tariffs, according to the state investment program, will be paid in addition to company's electricity tariff. For analytical purposes this investment surcharge could be treated as a loan with a zero interest rate and no repayment obligation. We have classified this item, after tax deduction, as equity with a zero cost, which will reduce WACC to 6.8% by the end of a 10-year forecasting period. Our model uses 12% WACC to perpetuity.

We also readjusted the company's trade receivables, re-classifying the amount of receivables offsetting long-term non-interest debt (refer to page 13) as long-term assets. This allows us to more correctly account for working capital changes in the DCF valuation.

Valuation date 4-Jul-06

For the purposes of forecasting local currency is used (mn)

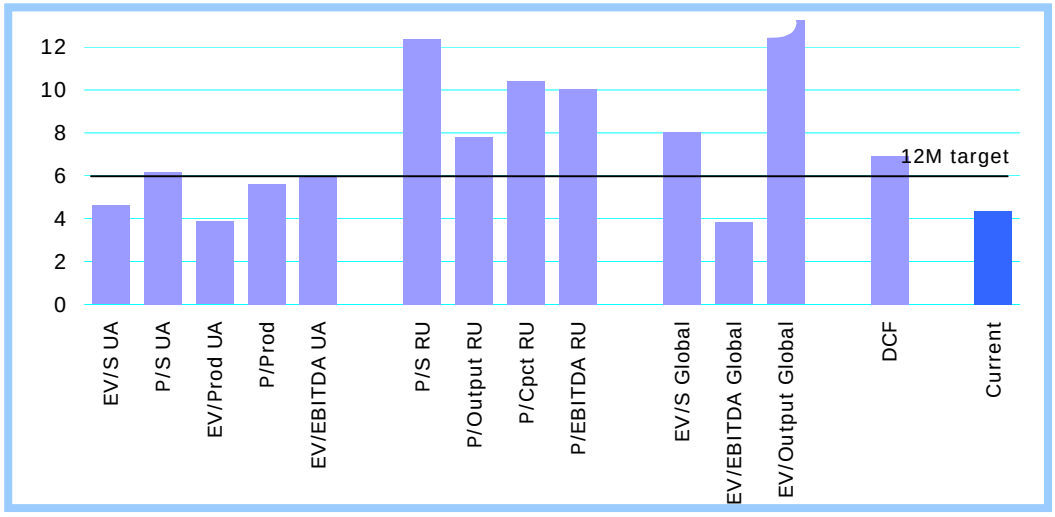
	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
EBITDA	**160**	**212**	**226**	**277**	**302**	**316**	**326**	**315**	**327**	**336**
EBIT	63	91	103	150	168	179	184	171	181	187
Tax Rate	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*
Taxed EBIT	47	68	77	112	126	134	138	129	136	141
(Including Investment Surcharge)	*46*	*80*	*80*	*120*	*130*	*130*	*110*	*55*	*55*	*55*
Plus D&A	97	121	123	128	134	137	141	144	146	148
Less CapEx	(150)	(157)	(162)	(180)	(185)	(192)	(170)	(155)	(150)	(150)
Less change in OWC	(10)	(2)	(1)	(1)	(0)	(13)	(2)	(7)	(7)	(1)
FCFF	**(15)**	**30**	**37**	**59**	**75**	**67**	**108**	**110**	**125**	**137**
WACC	14.3%	14.0%	13.1%	12.0%	11.0%	9.6%	8.9%	7.9%	7.0%	6.8%
WACC To Perpetuity										12%
Terminal Value										**1,402**
Firm Value		**1,059**				Proportion Due To TV				60.4%
Less Net Debt		225				Perpetuity Growth Rate				2.0%
Equity Value		**834**				Implied exit EBITDA multiple				**4.2x**
Current price, USD		**4.35**								
12 m target, USD		**6.92**								
Upside		59%								

Sensitivity Analysis

Implied Share Price, USD

WACC	Perpetuity Growth Rate				
	1.0%	***1.5%***	***2.0%***	***2.5%***	***3.0%***
-1.5%	7.25	7.53	7.84	8.19	8.57
-1.0%	6.95	7.22	7.52	7.85	8.22
-0.5%	6.66	6.92	7.21	7.53	7.89
+0.0%	6.39	6.64	**6.92**	7.22	7.57
+0.5%	6.12	6.37	6.63	6.93	7.26
+1.0%	5.87	6.10	6.36	6.65	6.96
+1.5%	5.63	5.85	6.10	6.37	6.68

Valuation Summary, USD mln



We estimate DOEN's 12M target at USD 6.0, implying a 38% upside. **BUY**.

All financial statements according to Ukrainian Accounting Standards
Trade Receivables and Other Fixed Assets adjusted by Concorde Capital

Income Statement Summary, USD mn

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Net Revenues	**203**	**170**	**211**	**232**	**246**	**266**	**279**	**290**	**302**	**308**	**318**	**328**
Change y-o-y	*N/M*	*-16%*	*24%*	*10%*	*6%*	*8%*	*5%*	*4%*	*4%*	*2%*	*3%*	*3%*
Cost Of Sales	(147)	(129)	(162)	(173)	(183)	(192)	(199)	(206)	(215)	(222)	(229)	(237)
Gross Profit	56	40	48	59	63	74	80	84	87	86	89	92
Other Operating Income												
SG&A	(5)	(6)	(7)	(7)	(8)	(8)	(8)	(9)	(9)	(10)	(10)	(10)
EBITDA	**3.4**	**24.8**	**32.1**	**42.4**	**45.2**	**55.5**	**60.4**	**63.2**	**65.1**	**63.0**	**65.5**	**67.1**
EBITDA margin, %	1.7%	14.6%	15.2%	18.2%	18.4%	20.8%	21.6%	21.8%	21.6%	20.4%	20.6%	20.4%
Depreciation	(6)	(17)	(19)	(24)	(25)	(26)	(27)	(27)	(28)	(29)	(29)	(30)
EBIT	**(3)**	**8**	**13**	**18**	**21**	**30**	**34**	**36**	**37**	**34**	**36**	**37**
EBIT margin, %	-1.3%	4.8%	6.0%	7.9%	8.4%	11.3%	12.1%	12.3%	12.2%	11.1%	11.4%	11.4%
Interest Expense	(4)	(4.5)	(5)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)
Financial income/(expense)	0	0	-	-	-	-	-	-	-	-	-	-
Other income/(expense)	(24)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)
PBT	**(30)**	**0**	**5**	**9**	**11**	**21**	**25**	**27**	**28**	**25**	**27**	**28**
Tax	(2)	0	(1)	(2)	(3)	(5)	(6)	(7)	(7)	(6)	(7)	(7)
Effective tax rate	*-8%*	*-27%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*
Extraordinary Income/(loss)	-	-	-	-	-	-	-	-	-	-	-	-
Net Income	**(32.5)**	**0**	**3**	**7**	**8**	**15**	**18**	**20**	**21**	**19**	**20**	**21**
Net Margin, %	*-16%*	*0.1%*	*1.6%*	*3.1%*	*3.4%*	*5.8%*	*6.6%*	*6.9%*	*6.9%*	*6.2%*	*6.3%*	*6.5%*
Dividend Declared	**0.5**	**-**	**-**	**-**	**-**	**-**	**-**	**0.2**	**2.0**	**2.5**	**3.0**	**3.5**

Balance Sheet Summary, USD mn

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Current Assets	**146**	**153**	**157**	**170**	**175**	**181**	**186**	**193**	**194**	**193**	**201**	**208**
Cash & Equivalents	17	19	22	24	25	24	22	23	21	18	19	20
Trade Receivables	87	90	86	93	95	100	104	107	110	109	114	118
Inventories	25	27	29	31	33	34	34	37	36	38	39	40
Other current assets	17	17	21	22	22	24	25	26	27	28	29	30
Fixed Assets	**377**	**402**	**403**	**400**	**398**	**399**	**399**	**400**	**396**	**398**	**399**	**399**
PP&E, net	217	216	232	334	340	356	377	386	395	398	398	399
Other Fixed Assets	159	186	171	66	58	43	21	14	0	0	0	0
Total Assets	**522**	**555**	**560**	**571**	**573**	**580**	**585**	**593**	**590**	**591**	**599**	**607**
Shareholders' Equity	**150**	**160**	**186**	**210**	**222**	**233**	**248**	**251**	**265**	**272**	**264**	**289**
Share Capital	44	44	44	44	44	44	44	44	44	44	44	44
Reserves and Other	215	227	251	267	270	266	262	246	242	231	207	213
Retained Earnings	(110)	(115)	(121)	(126)	(129)	(132)	(133)	(133)	(130)	(127)	(124)	(119)
Investment Allocations			9	21	33	51	71	90	107	120	134	147
Current Liabilities	**166**	**186**	**185**	**193**	**196**	**203**	**207**	**214**	**216**	**217**	**225**	**226**
ST Interest Bearing Debt	23	32	31	29	28	28	27	30	28	29	32	27
Trade Payables	51	47	48	45	46	44	46	45	46	46	48	50
Accrued Wages	1	1	1	1	1	1	1	1	1	1	1	1
Accrued Taxes	15	14	16	17	18	19	20	20	21	22	22	23
Other Current Liabilities	77	92	89	100	103	111	114	118	119	118	122	125
LT Liabilities	**206**	**210**	**189**	**168**	**156**	**144**	**130**	**127**	**109**	**103**	**110**	**91**
LT Interest Bearing Debt	66	71	59	48	46	44	40	47	39	43	50	31
Other LT	141	139	130	120	110	100	90	80	70	60	60	60
Total Liabilities & Equity	**522**	**555**	**560**	**571**	**573**	**580**	**585**	**593**	**590**	**591**	**599**	**607**

Cash Flow Statement Summary, USD mn

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Net Income	(32)	0	3	7	8	15	18	20	21	19	20	21
Depreciation	6	17	19	24	25	26	27	27	28	29	29	30
Non-operating and non-cash i	27	17	24	16	3	(4)	(4)	(7)	3	(14)	(18)	13
Changes in working capital	(90)	(9)	(2)	(0)	(0)	(0)	(0)	(3)	(0)	(1)	(1)	(0)
Operating Cash Flow	(89)	26	45	47	36	37	41	38	51	32	30	63
Capital Expenditures, net	(45)	(19)	(30)	(31)	(32)	(36)	(37)	(38)	(34)	(31)	(30)	(30)
Other Investments, net	0	0	-	-	-	-	-	-	-	-	-	-
Investing Cash Flow	(45)	(19)	(30)	(31)	(32)	(36)	(37)	(38)	(34)	(31)	(30)	(30)
Net Borrowings/(repayments)	43	7	(12)	(13)	(3)	(1)	(6)	11	(10)	5	10	(23)
Dividends Paid	-	(0)	-	-	-	-	-	(9)	(9)	(9)	(9)	(10)
Other	97	(14)	-	-	-	-	-	-	-	-	-	-
Financing Cash Flow	140	(7)	(12)	(13)	(3)	(1)	(6)	2	(19)	(4)	1	(33)
Beginning Cash Balance	N/A	17	19	22	24	25	24	22	23	21	18	19
Ending Cash Balance	17	18	22	24	25	24	22	23	21	18	19	20
Net Cash Inflows/Outflow	6	0	3	2	0	(1)	(2)	1	(2)	(3)	1	1

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