



CONCORDE CAPITAL

# Ukraine/ Iron & Steel

## Alchevsk Iron & Steel

### Buy Cheap For Growth

# BUY

11 Oct 2006

USD 0.05

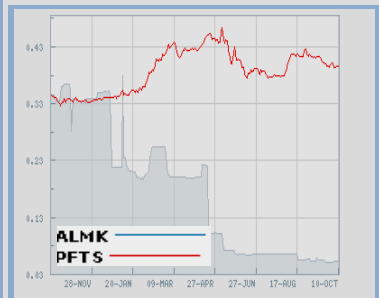
12m Target

USD 0.07

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**Long a fundamentally attractive asset, ALMK restored its stock market appeal after its bid-ask spread shrank to a reasonable level in September. With a warranted upside of 40%, we upgrade the stock from HOLD to BUY.**

ALMK Mid-Market, UAH



#### Market Information

Bloomberg ALMK UZ

No of Sh., mln 10,775.3

Market Price, USD 0.05

52Wk H/L, USD 0.37/0.05

MCap, USD mln 533.4

Free Float, % 7%

#### Stock Ownership

IUD 93%

Minorities 7%

#### Ratios 1H06

EBITDA Margin 8.1%

Net Margin 1.7%

**Dramatic Upgrade of ALMK's Production Facilities Due in Early 2007.** As part of its USD 1.2 bln investment program for 2004-2010, Alchevsk Iron & Steel mill is set to complete a major phase of modernization by spring 2007: the installation of a second concaster to bring the total continuously cast slab capacity to 5 mln tons/yr, construction of a basic oxygen furnace and the complete overhaul of one of its four blast furnaces. In 2010, ALMK's annual steel production capacity is planned to be 6.5 mln tons/yr (from 4 mln currently), which would make it Ukraine's third largest steel producer and operator of the most efficient steel production facilities in the country.

**Financials Recovered in 2Q06.** After a disappointing 1Q06, ALMK posted a much stronger 2Q06, with sales up 37.3% yoy (in 1Q06, sales declined 17.0% yoy), an EBITDA margin of 8.8% (6.6% in 1Q06) and net margin of 2.8% (-0.5% in 1Q06). We think sales will continue to grow in 2H06, driven by improved output (rolled steel production is up 15.7% yoy in 8M06 vs. 14.5% growth in 1H06) and high, although below peak, steel prices. We think by year end ALMK will be able to post 26% yoy revenue growth, an EBITDA margin of 11.0% and net margin of 4.0% and re-iterate the projections from our Metals and Mining report in August.

**Corporate Governance Set To Improve.** ALMK has been slow to cut transfer pricing, which is reflected mainly in its volatile and low margins (by industry standards). However, we expect this to change within the next two years, when IUD, ALMK's controlling shareholder, goes public. We also believe that the risk of minority shareholder dilution by ALMK (e.g., in the event of a merger with Alchevsk Coke) is now diminished as investors are now better equipped to protect their interests because of legislative changes to the share buy-back rules during mergers and reorganizations (effective since September 2006) and a recent decision by the Kyiv Economic Court in favor of minority shareholders on Zaporizhstal's share issue.

**Attractively Valued Growth.** By September 2006, the market finally digested ALMK's 14-fold share issue, as the bid-ask spread (as a % of the ask quote) declined from 90% in January-April to its current level at 33%. Based on the mid-market price, ALMK appears undervalued compared to its international peers based on the EV/S multiple, which we argue is a more appropriate metric than EV/EBITDA and P/E due to misreported production costs. Our target price of USD 0.07 per share offers a 40% upside for the stock, which justifies an upgrade from HOLD to BUY.

#### KEY FINANCIAL DATA, USD mln

	Net Revenue	EBITDA	Net Income	DPS, USD
2005	922.7	136.5	78.4	0.0
2006E	1,161.5	127.8	46.5	0.0
2007E	1,277.6	153.3	76.7	0.0

#### KEY RATIOS

	EV/S	EV/EBITDA	P/E	Div Yield
2005	0.72	5.24	6.87	0.0%
2006E	0.64	5.78	11.60	0.0%
2007E	0.58	4.82	7.02	0.0%

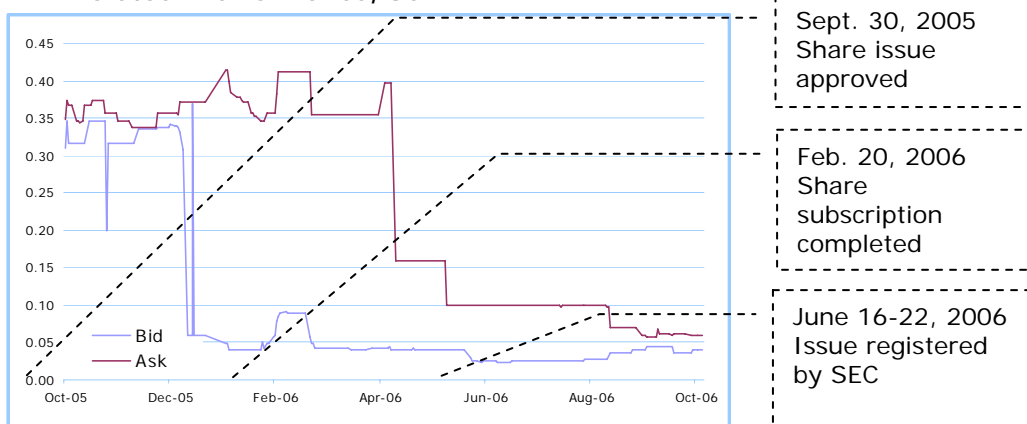
## Appendix

### Peer Comparison, 2006 Forward Looking Multiples

Company	Current Price, USD	MCap, USD mn	EV/S	EV/EBITDA	P/E
ALMK	0.05	538.8	0.64	5.78	11.60
<b>International Peers</b>					
INI Steel	32.9	2,800.1	0.79	5.7	5.5
Bluescope Steel	4.9	3,499.8	0.74	4.3	6.2
Tangshan	0.3	1,051.3	0.54	4.4	7.4
Maanshan	0.3	2,235.1	0.80	4.4	6.1
IPSCO	87.1	3,999.9	1.23	3.9	6.9
CSN	30.7	8,318.8	2.38	5.1	9.1
Arcelor Brazil	17.7	11,525.0	1.97	5.2	7.6
SSAB	19.7	5,165.1	1.35	5.6	9.3
<b>Average</b>			1.22	5.0	7.3
<b>Median</b>			1.01	7.0	7.1
Implied price by average, USD			<b>0.11</b>	<b>0.04</b>	<b>0.03</b>
Implied price by median, USD			<b>0.09</b>	<b>0.04</b>	<b>0.03</b>
Upside (downside) by average			127%	-20%	-37%
Upside (downside) by median			81%	-25%	-38%

Source: Company data; Concorde Capital; Bloomberg

### 12-mo Stock Performance, USD



Source: PFTS; Interfax

## Reported Net Quarterly Financials, UAS

### Income Statement Summary, USD mln

	1Q04	2Q04	3Q04	4Q04	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06
<b>Net Revenues</b>	<b>153</b>	<b>193</b>	<b>220</b>	<b>238</b>	<b>227</b>	<b>267</b>	<b>228</b>	<b>271</b>	<b>188</b>	<b>367</b>
Cost Of Sales	(145)	(180)	(208)	(222)	(190)	(210)	(188)	(224)	(161)	(311)
<i>% of Net Revenues</i>	<i>94.6%</i>	<i>93.2%</i>	<i>94.6%</i>	<i>93.4%</i>	<i>83.7%</i>	<i>78.6%</i>	<i>82.5%</i>	<i>82.6%</i>	<i>85.8%</i>	<i>84.6%</i>
Gross Profit	8	13	12	16	37	57	40	47	27	57
<i>% of Net Revenues</i>	<i>5.4%</i>	<i>6.8%</i>	<i>5.4%</i>	<i>6.6%</i>	<i>16.3%</i>	<i>21.4%</i>	<i>17.5%</i>	<i>17.4%</i>	<i>14.2%</i>	<i>15.4%</i>
Other Operating Income/Costs, net	9	(1)	8	(1)	(1)	(2)	(3)	(4)	0.5	(7)
SG&A	(5)	(6)	(6)	(6)	(6)	(7)	(12)	(10)	(15)	(17)
<i>% of Net Revenues</i>	<i>3.4%</i>	<i>3.0%</i>	<i>2.8%</i>	<i>2.4%</i>	<i>2.8%</i>	<i>2.8%</i>	<i>5.1%</i>	<i>3.6%</i>	<i>7.9%</i>	<i>4.6%</i>
<b>EBITDA</b>	<b>12</b>	<b>6</b>	<b>13</b>	<b>9</b>	<b>30</b>	<b>48</b>	<b>26</b>	<b>34</b>	<b>12</b>	<b>32</b>
<i>EBITDA margin, %</i>	<i>8.1%</i>	<i>3.2%</i>	<i>6.1%</i>	<i>3.7%</i>	<i>13.0%</i>	<i>17.8%</i>	<i>11.3%</i>	<i>12.4%</i>	<i>6.6%</i>	<i>8.8%</i>
Depreciation	(4)	(5)	(4)	(5)	(4)	(5)	(5)	(6)	(8)	(7)
<b>EBIT</b>	<b>8</b>	<b>1</b>	<b>9</b>	<b>4</b>	<b>25</b>	<b>43</b>	<b>20</b>	<b>27</b>	<b>5</b>	<b>25</b>
<i>EBIT margin, %</i>	<i>5.4%</i>	<i>0.8%</i>	<i>4.2%</i>	<i>1.8%</i>	<i>11.2%</i>	<i>16.0%</i>	<i>9.0%</i>	<i>10.1%</i>	<i>2.6%</i>	<i>6.9%</i>
Interest Expense	(0.3)	(0)	(0)	(0)	(0.2)	(0)	(1)	(4)	(4.0)	(4)
Financial income/(expense)	0.0	0	0	0	0.0	0	0	0	0.0	0
Other income/(expense)	(1)	(0)	0	(0)	(0)	(0)	(0)	(0)	(0)	(0)
<b>PBT</b>	<b>7</b>	<b>1</b>	<b>9</b>	<b>4</b>	<b>25</b>	<b>42</b>	<b>19</b>	<b>23</b>	<b>1</b>	<b>21</b>
Tax	(4)	(2)	(5)	(2)	(6)	(11)	(8)	(6)	(2)	(10)
<i>Effective tax rate</i>	<i>52%</i>	<i>212%</i>	<i>50%</i>	<i>56%</i>	<i>24%</i>	<i>27%</i>	<i>40%</i>	<i>27%</i>	<i>229%</i>	<i>50%</i>
Extraordinary Income/(loss)	-	-	-	-	-	-	-	-	-	-
<b>Net Income</b>	<b>4</b>	<b>(1)</b>	<b>5</b>	<b>2</b>	<b>19</b>	<b>31</b>	<b>11</b>	<b>17</b>	<b>(1)</b>	<b>10</b>
<i>Net Margin, %</i>	<i>2.3%</i>	<i>-0.7%</i>	<i>2.1%</i>	<i>0.7%</i>	<i>8.4%</i>	<i>11.6%</i>	<i>5.0%</i>	<i>6.2%</i>	<i>-0.5%</i>	<i>2.8%</i>

### Balance Sheet Summary, USD mln

	1Q04	2Q04	3Q04	4Q04	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06
<b>Current Assets</b>	<b>125</b>	<b>122</b>	<b>117</b>	<b>102</b>	<b>184</b>	<b>232</b>	<b>346</b>	<b>292</b>	<b>431</b>	<b>549</b>
Cash & Equivalents	0	3	3	4	5	5	91	3	4	6
Trade Receivables	59	30	23	23	30	67	37	42	58	136
Inventories	47	61	57	42	77	78	87	88	151	114
Other current assets	20	28	34	34	71	82	130	159	218	293
<b>Fixed Assets</b>	<b>123</b>	<b>124</b>	<b>130</b>	<b>142</b>	<b>165</b>	<b>194</b>	<b>238</b>	<b>263</b>	<b>302</b>	<b>352</b>
PP&E, net	112	110	109	109	117	116	120	177	175	175
Other Fixed Assets	11	15	21	33	48	78	118	86	127	177
<b>Total Assets</b>	<b>248</b>	<b>246</b>	<b>247</b>	<b>244</b>	<b>349</b>	<b>426</b>	<b>584</b>	<b>555</b>	<b>733</b>	<b>901</b>
<b>Shareholders' Equity</b>	<b>70</b>	<b>69</b>	<b>73</b>	<b>74</b>	<b>96</b>	<b>127</b>	<b>139</b>	<b>158</b>	<b>240</b>	<b>321</b>
Share Capital	23	23	23	23	24	24	24	25	25	189
Reserves and Other	103	103	102	96	99	99	100	99	191	96
Retained Earnings	(57)	(58)	(52)	(45)	(28)	4	15	34	24	36
<b>Current Liabilities</b>	<b>178</b>	<b>177</b>	<b>174</b>	<b>170</b>	<b>253</b>	<b>298</b>	<b>272</b>	<b>223</b>	<b>294</b>	<b>373</b>
ST Interest Bearing Debt	7	6	6	5	5	5	5	5	5	13
Trade Payables	146	144	134	132	193	219	238	195	231	263
Accrued Wages	2	2	2	2	2	2	3	3	3	3
Accrued Taxes	3	2	5	1	4	11	6	2	1	1
Other Current Liabilities	20	23	28	31	49	61	20	18	54	94
<b>LT Liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>173</b>	<b>175</b>	<b>200</b>	<b>207</b>
LT Interest Bearing Debt	-	-	-	-	-	-	173	175	199	205
Other LT	-	-	-	-	-	-	-	-	1	1
<b>Total Liabilities &amp; Equity</b>	<b>248</b>	<b>246</b>	<b>247</b>	<b>244</b>	<b>349</b>	<b>426</b>	<b>584</b>	<b>555</b>	<b>733</b>	<b>901</b>

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