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Analyst's Notebook

Ukraine / Mining
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****Editor's Note:** The Analyst's Notebook is Concorde Capital's fast response tool for keeping our coverage of the Ukrainian market as up to date as possible. Unlike our more in-depth desk notes and reports, Analyst's Notebook provides rapid feedback on breaking news in the Ukrainian market. Analyst's Notebook gives you our analysts' first impressions of a situation and may set the table for further investigation. Our analysts will use their experience in their sectors to take a look at the situation and provide insight or speculate on possible scenarios. We want to emphasize however, this product consists mostly of the analyst's intuition and may require further analysis.

The Market Overacted To Pivdenny GOK's New Share Issue

Share Subscription Over

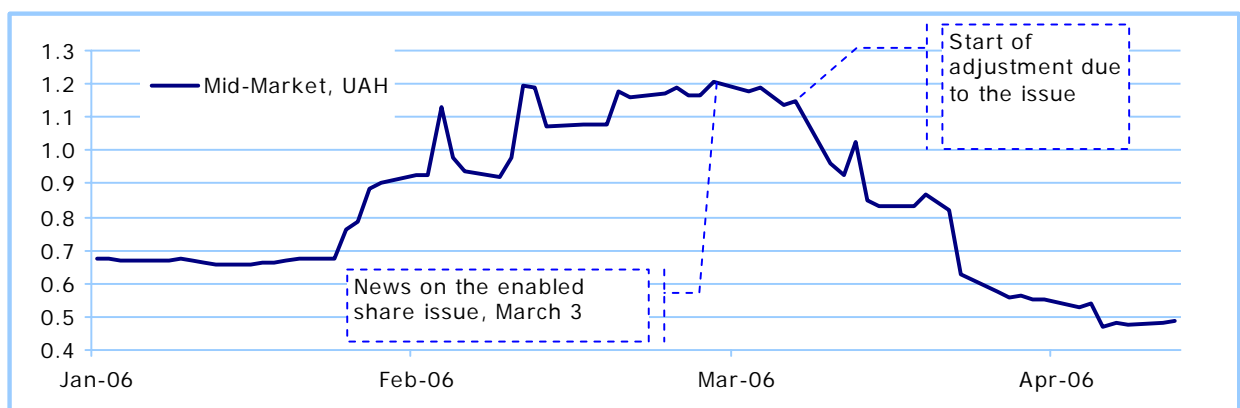
In early April, Pivdenny Iron Ore (**PGZK: BUY**) conducted its additional share issue which tripled the company's charter fund. As we mentioned in our ANB on March 9, 2006, the subscription for the new shares was scheduled to end on April 7, 2006. Minority shareholders had the opportunity to preserve their stake from dilution by subscribing for their portion of the additionally issued shares.

Effect On Target Price

As a result of the issue, we have calibrated our previous target price of USD 0.33 per share to USD 0.14 per share. The new target resulted from the interplay of two factors: the increase in the number of shares that effectively led to a per share price reduction and inflow of share issue proceeds that boosted the company's total cash flow and thus amplified its MCap and share price.

Market Reaction

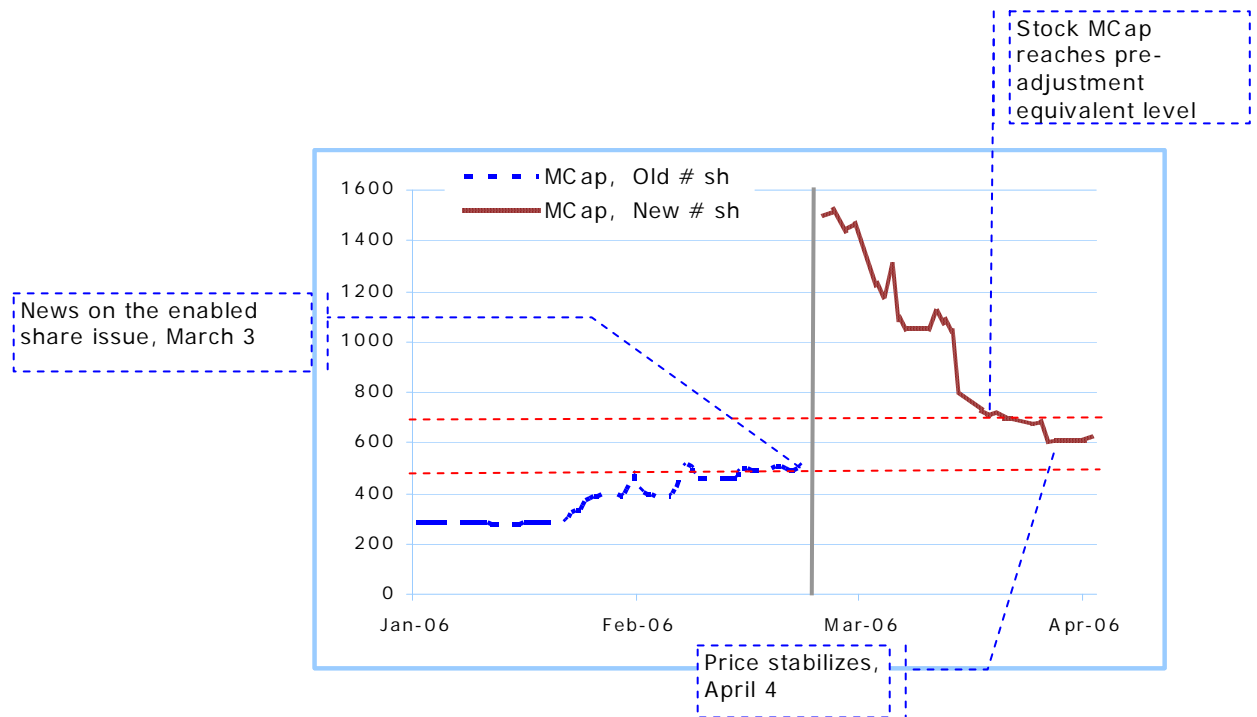
Stock price dynamics on the PFTS reflected the changes in the market perception of the share issue likelihood by a downward market price adjustment when the market finally recognized that the issue was inevitable. The news about the court ruling that enabled this share issue was publicized on March 3, 2006, and the market responded to it a week later. The price has been falling since early March and has only recently stabilized. The slow pace of the adjustment created the illusion that the company's value was eroding. We do not share this view and offer our explanation for this phenomenon below.



What Really Happened To MCap?

Even though the additional share issue has not yet been registered by Ukraine's State Securities and Exchange Commission (SEC), due to the fact that the market was re-pricing PGZK's stock to allow for the tripled number of shares, we argue that a more meaningful calculation of MCap should be based on the greater number of shares starting from early March. As the chart above shows, the PFTS price for PGZK, and thus MCap using the old number of shares, started to decline on March 10 although nothing negative happened to the company's business.

We recalibrated MCap using the new number of shares starting from March 4 and obtained a more meaningful plot for PGZK's MCap.



We estimate that PGZK's MCap expected after the issue would be a sum of a pre-adjustment MCap that preceded the news on the court ruling on PGZK (USD 512 mln on March 3) and the estimated share issue proceeds (USD 212 mln). In fact, PGZK's MCap based on the new number of shares crept to this level in March 27-29, (red dotted horizontal bars capture the effect of issue proceeds inflow on the chart above), but the sliding continued until April 4. On that day, PGZK closed subscription for its additionally issued shares and the company's MCap based on the new number of shares was close to its MCap based on the old number of shares before prices started dropping on March 10.

The ambiguity about the future number of shares outstanding was the reason behind the delay in the of market's reaction regarding the stock price. It took prices three weeks to factor in the share issue and furthermore, the market over-reacted discounting PGZK's price, which in equivalent terms, fell below the pre-adjustment equivalent level. Given that the share issue uncertainty has settled down, we expect an upward trend for the stock to resume. The latest stock price is USD 0.11, signifying a 27% upside to our target of USD 0.14. We stand behind our **BUY** recommendation.

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