



CONCORDE CAPITAL

Ukraine / Coke

Avdiyivka Coke

1Q results gift bag

May 14, 2008

Current price: USD 3.91
12M Target: USD 7.32

BUY

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Yesterday Avdiyivka Coke's 1Q08 financials became available: sales grew 154% yoy to USD 416 mln, and its net margin reached 13.6%, which we estimate is the highest in the industry. At the same time, output grew 36% yoy to 1.2 mln mt of coke. Given the upbeat results and favorable market conditions, we upgrade our target to USD 7.32 and reiterate BUY (87% upside).

Tickers

Bloomberg AVDK UZ

Market information

Market price, USD	3.91
MCap, USD mln	756.2
52Wk Hi/Lo, USD	4.5/2.43
No of shares, mln	193.6
Free float	3.2%
Free float, USD mln	24.2

Corporate Governance

Concorde Rating* A

* The rating is based on Concorde Capital's corporate governance survey. Q denotes quality corporate governance standards, AA - above average standards, A - average, BA - below average and P - poor.

Shareholders

Metinvest	90.9%
MMK Illicha Steel	5.9%
Other	3.2%

Ratios 2008E

EBITDA margin	18.0%
Net margin	9.8%

Financials cleaning up, 1Q08 net margin surged to 13.6%

The company's 1Q08 sales were USD 416 mln, up 2.5x yoy, while its net margin was 13.6%, up 20 pp yoy. Pretax margin reached 19.1% vs. negative 4.3% in 2007. This and the fact that the share of non-core steel in sales is declining (down 11 pp in 2007 to 16% of Avdiyivka's revenues) confirm our view that the company is improving financial disclosure and unlocking value on the eve of a possible IPO by parent Metinvest.

Output up 36% yoy, on pace to reach our 2012 estimate this year

The company boosted production in 1Q08 to 1.16 mln mt of coke (+36% yoy). Given its strong 1Q08, Avdiyivka Coke is likely to reach our 2012 forecast of 4.7 mln mt already by YE2008. In January, Avdiyivka launched coke battery #3 with a capacity of 690 ths mt of coke p.a. and plans to bring a fourth battery with the same capacity onstream in 2009. With these batteries, the company's overall capacity will total 6.12 mt of coke p.a., 1.7x higher than 2007 output.

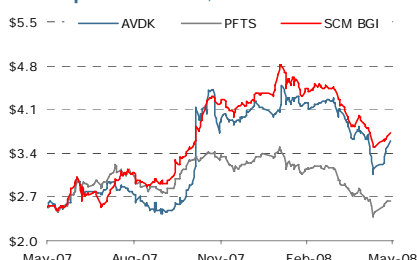
Strong coke prices translate into surge in cash earnings

As of early May, domestic spot coke prices were up 70% from their average in 2007, in line with the similar rise seen in coal. This resulted in a 70% increase in the average industry gross margin from USD 62 per mt of met coke in 2007 to USD 105 this month. On the back of strong demand and soaring global coke & coal prices, we forecast Ukrainian spot domestic and export prices in 2008 at USD 340-360 and USD 410-420, respectively. Thus, we expect margins across the industry to remain firm.

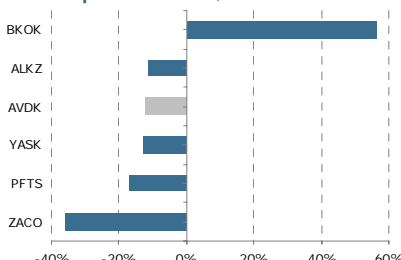
Upgraded target suggests more upside

With positive sentiment seemingly returning to the market, we see this as a favorable time to BUY. Our upgraded target of USD 7.31 suggests 102% upside.

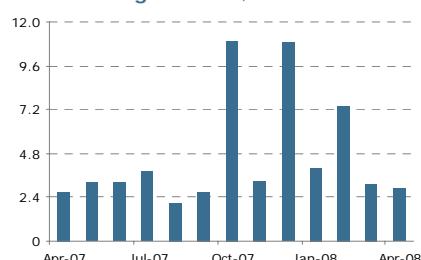
Stock performance, 12M*



Sector performance, YTD



PFTS trading volumes, USD ths



Source: PFTS, Bloomberg. * PFTS index, SCM BGI rebased to AVDK's price

Key financials & ratios, USD mln

	Revenue	EBITDA margin	Net margin	EV/S	EV/EBITDA	P/E
2007	963.9	11.5%	-4.3%	1.1	8.0	n/m
2008E	1,669.6	18.0%	9.8%	0.5	3.0	4.6
2009E	1,712.0	17.5%	9.9%	0.5	3.0	4.4

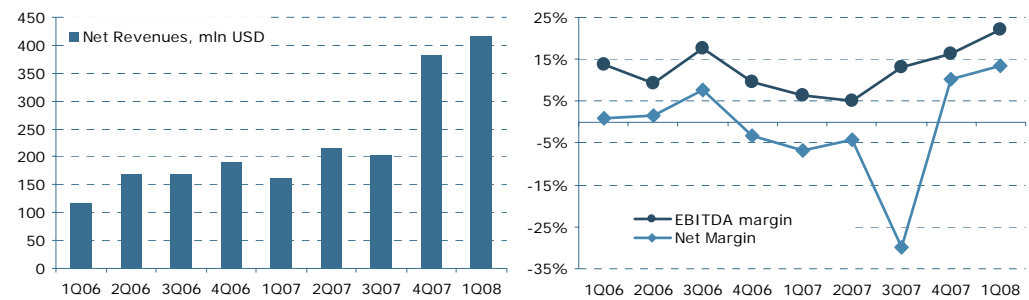
Spot exchange rate: 5.05 UAH/USD

Stronger financials: mix of fundamental and transparency improvement

Top line, financial statement quality improves since 4Q07

Over the last two quarters, Avdiyivka Coke almost doubled its top line: in 4Q07 revenues came to USD 382.7 mln (up 101% yoy); and in 1Q08 to USD 415.8 mln (up 154% yoy). We attribute the growth to the surge in output (up 28% yoy in 4Q07 and 36% in 1Q08) and skyrocketing coke prices (~100% since January 07).

Avdiyivka financials (quarterly)*



Source: Company data

* 1Q08 EBITDA margin is Concorde Capital estimate

In 2007, the share of non-core steel sales declined 11 pp to 16% of the company's total sales vs 27% in 2006. We estimate non-core sales amounted to roughly 15% of sales in the last two quarters. In our view, parent Metinvest will continue to clean up Avdiyivka's revenue in 2008-2009 as it prepares the group for IPO.

Reported margins jump sharply

In 4Q07, the company's bottom line turned positive (10.4% in 4Q07 and 13.6% in 1Q08). We think the negative net margins in 1Q07-3Q07 stemmed from:

- D&A charges.** In late 2006, the company reevaluated its assets, which caused high non-cash depreciation costs in 2007. According to Ukrainian Accounting Standards, the company uses an accelerated depreciation method, which recognizes greater depreciation expenses earlier in an asset's lifespan. We do not expect the company to reevaluate its assets again in next five years.
- One-off losses from non-operating activity.** In August 2007, Avdiyivka transferred a 92.1% stake in Pavlohrad Coal to DTEK, the group's energy wing, apparently at a lower price than paid at privatization in 2004.

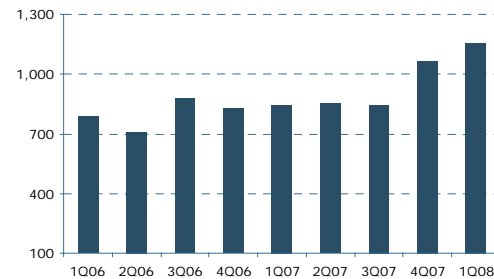
The company's EBITDA margin reached 11.5% in 2007, 3 pp higher than we forecasted due to solid performance in 2H07. Given that 1Q08 pretax margin grew to 19.1%, we estimate the company's EBITDA margin at 22% in 1Q08.

Production growth is ahead of our forecasts

Forecasts upgrade on management expectations, 1Q08 results

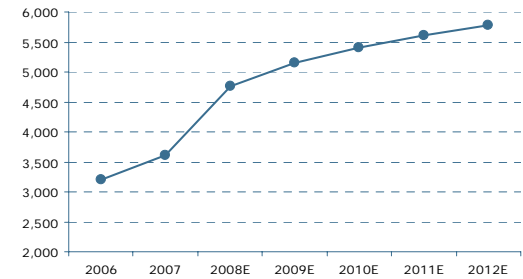
At the beginning of the year, the company's management said they were targeting 38% output growth in 2008 (4.98 mln mt), ahead of our previous expectations: we forecasted 4.7 mln mt by only 1Q08 production (+36% yoy), we revise our annual projections upward to 4.7 mln mt in 2008. In addition, we upgrade our long-term projection to 5.8 mln mt of coke in 2012, up 23%.

Average quarterly output, *ths mt*



Source: Metal-Expert, Concorde Capital estimates

Forecasted production, *ths mt*

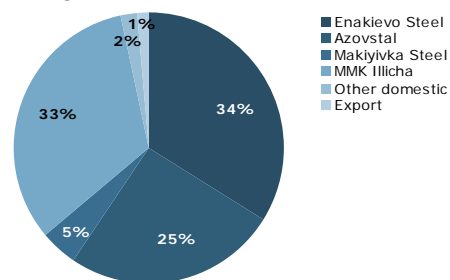


Contributors to the growth

We attribute Avdiyivka's strong operating performance over last 6M to:

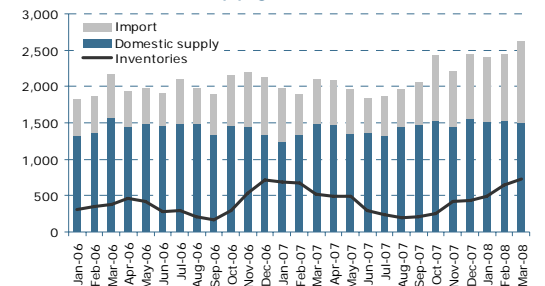
- strong demand within Metinvest group, particularly from Enakievo Steel and Makiyivka Steel (the latter was acquired by Metinvest in mid-2007)
- better coal supply to Ukraine: in 4M08 coking coal imports to Ukraine surged 54.3% yoy; according to Ukrainian coke association Ukrkoks, coking coal deliveries to coke producers grew 12.6% yoy in 4M08

Avdiyivka's 2007 sales breakdown



Source: Metal-Expert, Concorde Capital estimates

Ukrainian coal supply and inventories, *ths mt*



We think further production growth will be driven by:

- growth in coke consumption within Metinvest: Azovstal, Enakievo Steel and Makiyivka Steel
- redirection of coke production within Metinvest from Azovstal to Avdiyivka (Markokhim) in order improve the environment in Black Sea industrial city Mariupol
- escalating exports

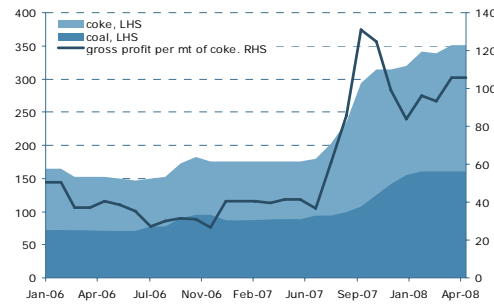
In January 2008, Avdiyivka's coke battery #3, with a capacity of 690 ths mt per annum, came on stream (in line with our expectation, see our December 4 note). Another battery of the same size is being overhauled and will be launched in 2009, bringing the mill's total capacity to 6.12 mln mt of coke p.a.

Coke market: Cash earnings & Competitiveness

Strong coke prices boost cash earnings

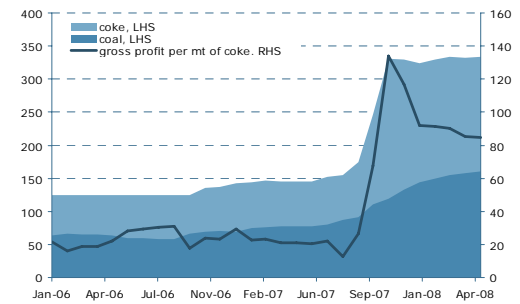
Similar spikes in coke prices (up 100-130% in the CIS since June 2007) and coal led the dollar difference between the prices of inputs (coal concentrate) and producer's final products (coke) to widen by 70% from June 2007 to May 2008.

Ukraine coal and coke prices, USD/mt (EXW)



Source: Metal-Expert

Russia coal and coke prices, USD/mt (EXW)



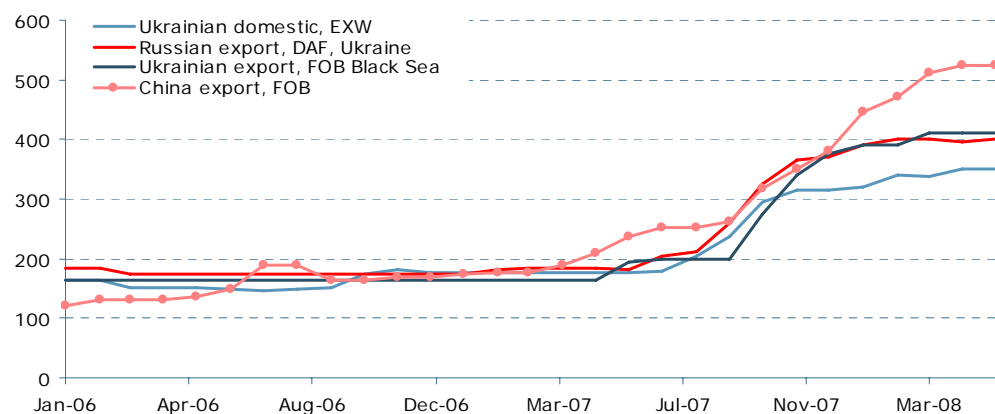
Given that coal accounts for nearly 80% of the total production cost of coke, the average gross profit per mt of coke for the coke industry grew from an average USD 62 in 2007 to USD 105 by May 2008.

Ukraine benefits from eroding competitiveness of Chinese coke

Even after this rise, domestic export and local prices still have room for further growth as they still undercut Chinese export prices by 22% and 33% respectively; which we believe secures Ukrainian producers' competitiveness. China, producer of 60% of the world's coke and trader of 46% of international coke, increased export duties on coke from 5% to 15% in June 2007 and again to 25% in January 2008. These higher tariffs continued some 20% to Chinese export price acceleration (which came to 150% yoy in May 2008).

Furthermore, local players benefit from a geographical advantage over China on European and CIS markets. Given that the freight rates from China to Europe increased from USD 25-40 to USD 50-70 since January 2007, current transportation costs add 10-15% to China FOB prices.

Coke prices, USD/mt



Source: Metal-Expert

Valuation

We derive Avdiyivka Coke's fair value based on DCF; relative valuation has limited applicability as most international peers are integrated with coal mines or steel smelters and are not geographically representative.

We revise our approach to valuation by excluding Avdiyivka's 99% stake in Krasnodoncoal. According to the management of parent Metinvest Holding, the stake is likely to be transferred to Metinvest itself. Even though this transaction may be carried out at par value, being on a conservative side, we do not factor this into our valuation of Avdiyivka.

Key model assumptions

	2007*	2008F	2009F	2010F	2011F	2012F
Coke price, USD/mt						
New	195.0	310.0	294.5	265.1	251.8	239.2
<i>Growth, yoy</i>		59.0%	-5.0%	-10.0%	-5.0%	-5.0%
Old	185.0	203.5	203.5	203.5	203.5	203.5
Production, ths mt						
New	3,609.0	4,763.9	5,145.0	5,402.0	5,618.3	5,786.9
<i>Growth, yoy</i>		32.0%	8.0%	5.0%	4.0%	3.0%
Old	3,438.7	3,769.1	4,043.4	4,274.0	4,648.1	4,743.9
Sales, USD mln						
New	963.9	1,668.8	1,712.2	1,618.0	1,598.6	1,564.2
<i>Growth, yoy</i>		73.1%	2.6%	-5.5%	-1.2%	-2.2%
Old	830.0	928.3	995.8	1,052.6	1,144.7	1,168.3
EBITDA, USD mln						
New	111.0	300.4	299.6	279.9	268.6	262.8
<i>Margin, new</i>	11.5%	18.0%	17.5%	17.3%	16.8%	16.8%
Old	70.5	125.3	139.4	147.4	160.3	163.6
<i>Margin, old</i>	8.5%	13.5%	14.0%	14.0%	14.0%	14.0%

Source: Metal-Expert, Company data, Concorde Capital estimates

* 2007 new – actual, 2007 old – Concorde's previous forecast

DCF valuation

Valuation as of May 08

UAH mln

	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
EBITDA	1,502	1,483	1,358	1,303	1,261	1,261	1,224	1,224	1,162	1,162
EBIT	1,240	1,223	1,101	1,049	1,012	1,016	982	987	929	935
Tax Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Taxed EBIT	930	917	825	786.7	758.8	761.8	736.8	740.2	697.1	701.1
Plus D&A	262	260	257	254	250	246	241	237	232	227
Less CapEx	(317)	(305)	(267)	(264)	(255)	(252)	(248)	(244)	(235)	(227)
Less change in OWC	(187)	213	180	127	123	105	77	-	5	-
FCFF	-	1,085	996	903	876	861	808	733	699	701
WACC	13.3%	13.3%	13.2%	13.0%	12.2%	11.2%	11.3%	11.3%	11.4%	11.4%
Sum of discounted CFs		4,847								
PV of Terminal Value		2,527								
Firm Value		7,374								
Portion due to TV		34.3%								
Less Net Debt		(218)								
Equity Value		7,157								
Implied share price, UAH		36.97								
Implied share price, USD		7.32								
							WACC To Perpetuity			11.0%
							Terminal Value			6,707
							Perpetuity Growth Rate			0.5%
							Implied Exit EBITDA Multiple			5.8x

Sensitivity of Avdiyivka Coke's 12M equity value, USD mln

10-Year Discount Rates	Perpetuity Growth Rate				
	-0.5%	0.0%	0.5%	1.0%	1.5%
WACC-1.0%	7,256	7,381	7,518	7,669	7,835
WACC-0.5%	7,082	7,202	7,334	7,479	7,639
WACC+0.0%	6,914	7,030	7,157	7,296	7,450
WACC+0.5%	6,752	6,864	6,986	7,120	7,268
WACC+1.0%	6,596	6,703	6,821	6,950	7,093

WACC to perpetuity	Perpetuity Growth Rate				
	-0.5%	0.0%	0.5%	1.0%	1.5%
10.0%	7,108	7,246	7,398	7,568	7,757
10.5%	7,006	7,132	7,271	7,424	7,595
11.0%	6,914	7,030	7,157	7,296	7,450
11.5%	6,830	6,937	7,053	7,181	7,321
12.0%	6,753	6,852	6,959	7,077	7,205

Source: Concorde Capital estimates

Quarterly financial statements

Income statement summary, USD mln

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08
Net Revenues	116.6	170.1	170.3	190.7	163.8	214.4	203.0	382.7	415.8
Cost Of Sales	(94.7)	(143.0)	(134.6)	(168.2)	(147.3)	(194.8)	(169.2)	(298.0)	
Gross Profit	21.9	27.1	35.8	22.4	16.5	19.6	33.8	84.7	
<i>Gross margin</i>	<i>18.8%</i>	<i>15.9%</i>	<i>21.0%</i>	<i>11.8%</i>	<i>10.1%</i>	<i>9.2%</i>	<i>16.7%</i>	<i>22.1%</i>	
Other Operating Income/Costs, net	(1.0)	(5.4)	(1.0)	1.2	(1.2)	(3.1)	(2.1)	(15.5)	
SG&A	(5.0)	(6.0)	(4.9)	(5.4)	(5.1)	(5.4)	(5.2)	(6.1)	
EBITDA	16.0	15.6	29.8	18.3	10.3	11.1	26.6	63.1	
<i>EBITDA margin</i>	<i>13.7%</i>	<i>9.2%</i>	<i>17.5%</i>	<i>9.6%</i>	<i>6.3%</i>	<i>5.2%</i>	<i>13.1%</i>	<i>16.5%</i>	
Depreciation	(4.1)	(4.2)	(4.3)	(4.6)	(13.9)	(14.7)	(15.3)	(14.8)	
EBIT	11.9	11.5	25.6	13.7	(3.6)	(3.6)	11.3	48.3	
<i>EBIT margin</i>	<i>10.2%</i>	<i>6.7%</i>	<i>15.0%</i>	<i>7.2%</i>	<i>-2.2%</i>	<i>-1.7%</i>	<i>5.6%</i>	<i>12.6%</i>	
Interest Expense	(7.5)	(5.8)	(4.8)	(3.6)	(3.6)	(3.1)	(4.0)	(3.4)	
Financial income/(expense)	-	-	-	(9.4)	0.0	0.0	0.0	1.0	
Other income/(expense)	(1.1)	0.4	(3.2)	(3.6)	0.3	1.1	(61.7)	(0.4)	
PBT	3.3	6.0	17.6	(2.8)	(7.0)	(5.6)	(54.4)	45.5	79.4
Tax	(2.0)	(3.5)	(4.3)	(3.6)	(4.0)	(3.1)	(6.5)	(9.6)	
Net Income	1.1	2.4	13.2	(6.4)	(11.0)	(8.7)	(60.9)	39.6	56.4
<i>Net Margin</i>	<i>1.0%</i>	<i>1.4%</i>	<i>7.8%</i>	<i>-3.4%</i>	<i>-6.7%</i>	<i>-4.0%</i>	<i>-30.0%</i>	<i>10.4%</i>	<i>13.6%</i>

Source: Company data

Balance sheet summary, USD mln

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07
Current Assets	231.5	163.8	164.4	162.7	303.8	220.3	581.4	675.7
Cash & Equivalents	13.1	8.8	3.2	3.7	2.8	2.1	3.5	102.5
Trade Receivables	40.0	52.2	69.1	31.0	130.1	53.6	128.4	105.3
Inventories	35.4	31.2	31.6	44.2	43.4	41.4	39.9	52.2
Other current assets	143.1	71.5	60.5	83.8	127.4	123.2	409.6	415.9
Fixed Assets	789.3	791.8	780.2	1,177.7	1,126.3	1,111.4	760.8	787.3
PP&E, net	131.1	137.6	135.3	434.6	428.0	417.2	408.3	395.3
Other Fixed Assets	658.2	654.2	644.9	743.1	698.3	694.2	352.5	392.0
Total Assets	1,020.8	955.6	944.6	1,340.4	1,430.1	1,331.7	1,342.2	1,463.0
Shareholders' Equity	580.0	582.4	594.9	846.5	840.7	834.5	773.4	822.4
Share Capital	67.5	67.5	67.5	67.5	67.5	67.5	67.5	67.5
Reserves and Other	122.2	122.0	121.5	341.9	332.6	322.9	290.3	286.5
Retained Earnings	390.4	392.9	405.9	437.1	440.5	444.1	415.6	468.4
Current Liabilities	239.3	342.1	193.2	252.2	349.4	309.8	404.6	394.7
ST Interest Bearing Debt	108.9	205.0	24.5	-	-	-	-	-
Trade Payables	55.8	60.5	51.9	140.4	237.5	203.8	273.0	275.3
Accrued Wages	1.2	1.2	1.2	1.2	1.3	1.3	1.5	1.8
Accrued Taxes	0.5	0.4	0.4	0.4	0.5	0.5	6.7	6.9
Other Current Liabilities	73.0	75.0	115.2	110.2	110.1	104.3	123.3	110.7
LT Liabilities	201.5	31.0	156.5	241.7	240.1	187.4	164.2	245.8
LT Interest Bearing Debt	177.9	7.5	133.0	150.0	150.0	99.6	100.0	200.0
Other LT	23.6	23.6	23.6	91.7	90.1	87.8	64.2	45.8
Total Liabilities & Equity	1,020.8	955.6	944.6	1,340.4	1,430.1	1,331.7	1,342.2	1,463.0

Source: Company data

Projected financials

Income statement summary, USD mln

	2006	2007	2008E	2009E	2010E	2011E	2012E
Net Revenues	648	964	1,669	1,712	1,618	1,599	1,564
<i>Change, yoy</i>	-42.6%	48.8%	73.1%	2.6%	-5.5%	-1.2%	-2.2%
Cost Of Sales	(540)	(809)	(1,293)	(1,335)	(1,270)	(1,263)	(1,236)
Gross Profit	107	155	375	377	348	336	328
Other Operating Income/Costs, net	(6)	(22)	(33)	(26)	(16)	(16)	(16)
SG&A	(21)	(22)	(42)	(51)	(52)	(51)	(50)
EBITDA	80	111	300	300	280	269	263
<i>EBITDA margin</i>	12.3%	11.5%	18.0%	17.5%	17.3%	16.8%	16.8%
Depreciation	(17)	(59)	(52)	(53)	(53)	(52)	(52)
EBIT	63	52	248	247	227	216	211
<i>EBIT margin</i>	9.7%	5.4%	14.9%	14.4%	14.0%	13.5%	13.5%
Interest Expense	(22)	(14)	(30)	(21)	(16)	(14)	(12)
Financial income/(expense)	(9)	1	-	-	-	-	-
Other income/(expense)	(8)	(61)	-	-	-	-	-
PBT	24	(22)	218	226	211	202	199
Tax	(13)	(23)	(54)	(57)	(53)	(51)	(50)
Net Income	10	(41)	163	170	158	152	149
<i>Net Margin</i>	1.6%	-4.3%	9.8%	9.9%	9.8%	9.5%	9.5%

Source: Concorde Capital estimates

Balance sheet summary, USD mln

	2006	2007	2008E	2009E	2010E	2011E	2012E
Current Assets	163	676	568	519	481	474	470
Cash & Equivalents	4	102	103	140	175	195	219
Trade Receivables	31	105	150	156	146	144	141
Inventories	44	52	65	67	64	63	56
Other current assets	84	416	250	156	97	72	55
Fixed Assets	1,178	787	806	832	842	844	854
PP&E, net	435	395	462	481	488	490	496
Other Fixed Assets	743	392	344	351	355	355	358
Total Assets	1,340	1,463	1,374	1,350	1,323	1,318	1,325
Shareholders' Equity	846	822	950	1,021	1,047	1,062	1,088
Share Capital	67	67	73	75	76	76	76
Reserves and Retained Earnings	779	755	877	946	972	987	1,012
Current Liabilities	252	395	264	217	179	177	174
ST Interest Bearing Debt	-	-	17	17	16	16	16
Trade Payables	140	275	194	162	127	126	124
Accrued Wages	1	2	2	2	2	2	2
Accrued Taxes	0	7	2	2	2	2	2
Other Current Liabilities	110	111	50	35	32	32	31
LT Liabilities	242	246	160	112	97	78	63
LT Interest Bearing Debt	150	200	160	112	97	78	63
Other LT	92	46	-	-	-	-	-
Total Liabilities & Equity	1,340	1,463	1,374	1,350	1,323	1,318	1,325

Source: Concorde Capital estimates

Appendix - Disclosures

Analyst Certification

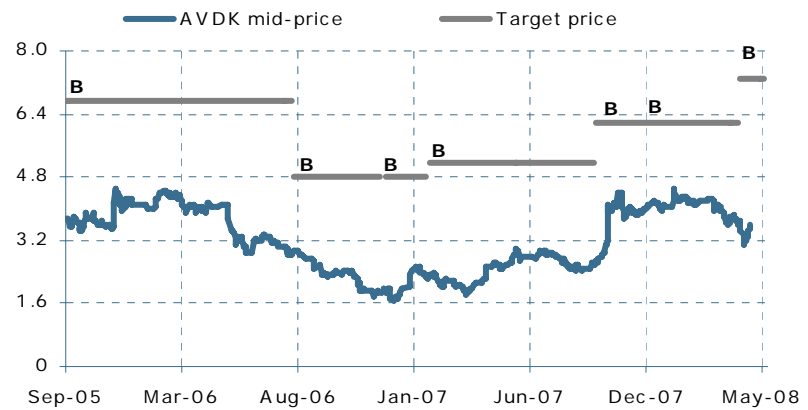
We, Andriy Gerus and Eugene Cherviachenko, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Avdiyivka Coke*

Date	Target price, USD	Market Price, USD	Rec'	Action
23-Sept-05	6.74	3.56	BUY	Initiating
23-Aug-06	4.79	2.96	BUY	Upgrade
29-Dec-06	4.79	2.00	BUY	Maintain
28-Feb-07	5.14	2.13	BUY	Maintain
17-Oct-07	6.20	3.08	BUY	Maintain
04-Dec-07	6.20	3.92	BUY	Maintain
14-May-08	7.31	3.91	BUY	Maintain

* Until March 2007 the company was covered by Andriy Gostik, who now focuses on another sector. In February 2007, Eugene Cherviachenko took over coverage; in October 2007, Andriy Gerus joined the metals & mining group.

AVDK Recommendation history, USD per share



Investment Ratings

The time horizon for target prices in Concorde Capital's research is 12 months unless otherwise stated. Concorde Capital employs three basic investment ratings: Buy, Hold and Sell. Typically, Buy recommendation is associated with an upside of 15% or more from the current market price; Sell is prompted by downside from the current market price (upside <0%); Hold recommendation is generally for limited upside within 15%. Though investment ratings are generally induced by the magnitude of upside, they are not derived on this basis alone. In certain cases, an analyst may have reasons to establish a recommendation where the associated range given above does not correspond. Temporary discrepancies between an investment rating and its upside at a specific point in time due to price movement and/or volatility will be permitted; Concorde Capital may revise an investment rating at its discretion. A recommendation and/or target price might be placed Under Review when impelled by corporate events, changes in finances or operations. Investors should base decisions to Buy, Hold or Sell a stock on the complete information regarding the analyst's views in the research report and on their individual investment objectives and circumstances.

Concorde Capital ratings distribution

Buy	52	45%
Hold	24	21%
Sell	20	17%
Under Review	19	17%
Total	115	100%

Investment banking clients*

Buy	6	100%
Hold	0	0%
Sell	0	0%
Under Review	0	0%
Total	6	100%

* Within the last twelve month period, Concorde Capital has obtained compensation from these companies for investment banking services.

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