



CONCORDE CAPITAL

Ukraine / Machine Building AZGM & MZVM

Kinder of Two of a Kind

July 17, 2007

12M Targets AZGM: USD 6.1
MZVM: USD 20.3

BUY

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Market information

	AZGM UZ
Bloomberg	
No of Shares, mln	46.5
Market price, USD	4.3
52Wk H/L, USD	2.6/4.3
MCap, USD mln	198.6
Free float	6%
FF MCap, USD mln	11.9
Mo avg tr volume*, USD mln	0.14
Concorde Corp Gov Rating	BA

Stock ownership

Azovmash	26.5%
UPTK	59.5%
Other	14.0%

Market information

	MZVM UZ
Bloomberg	
Frankfurt/Xetra	M9X GR
No of Shares, mln	15.4
Reg S GDR to Ord.	1:1
Market price, USD	15.7
52Wk H/L, USD	8.5/16.9
MCap, USD mln	241.6
Free float	15%
FF MCap, USD mln	36.3
Mo avg tr volume*, USD mln	1.56
Concorde Corp Gov Rating	A

Stock ownership

Azovmash	50.0%
UPTK	24.0%
State	11.0%
Other	15.0%

* 6M trailing, PFTS

The recent appointment of Azovmash Holding's top manager as Azovzahalmash's CEO and superior revenue forecasts disclosed by management signal that Azovzahalmash is emerging as the flagship of the group. In a meeting with us, UPTK, a controlling shareholder, confirmed that AZGM is being positioned as the leader of the pair. We upgrade our recommendation on Azovzahalmash to **BUY**, while maintaining our **BUY** on Mariupol Heavy Machinery and upgrading both target prices.

Azovzahalmash coming into the spotlight

The recent AGMs of the two traded Azovmash Holding companies offered the clearest indicator yet that Azovzahalmash is becoming the main player in the group. Holding CEO Vladimir Telitsya was elected Chief Executive Officer of Azovzahalmash at its AGM on June 30, and removed as the top official of Mariupol Heavy Machinery two days later.

We spoke with the top management of UPTK, Azovmash's major shareholder, after the AGMs. They shared with us plans for top-line growth of at least 15% for the holding in 2007, and confirmed that Azovzahalmash's sales will grow faster than Mariupol Heavy Machinery in the mid-term. Azovzahalmash's share in the group's aggregate sales has increased steadily from 35.3% in 2005 to 48% 1Q07.

UPTK has an incentive to favor Azovzahalmash

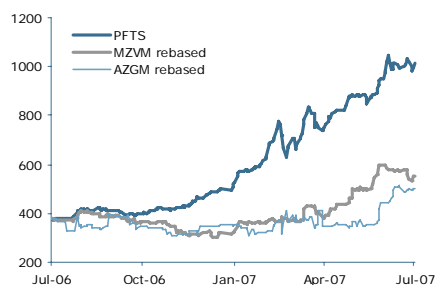
In our view, UPTK's goal is to unite all of the Azovmash companies (Azovzahalmash, Mariupol Heavy Machinery, the Research Institute and Mariupol Thermic Plant) into a single enterprise by swapping shares in the companies for Azovmash shares. Azovmash currently has stakes in all of these companies (26% to 51%) and is jointly controlled by the state (50%+1 stake) and UPTK.

If UPTK, which holds a larger share in Azovzahalmash than the state, can augment the company's relative value within the group, then it would have more leverage to negotiate a higher exchange ratio from the state during the desired merger. UPTK is likely to preserve Mariupol Heavy Machinery's value in order to ensure the government's support.

BUY the pair

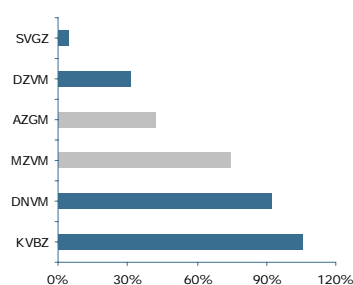
We remain positive on both stocks. The updated target prices are: **USD 6.1** (30.8% upside) for **AZGM** and **USD 20.3** (28.8% upside) for **MZVM**, with **BUY** recommendation for both companies.

Stocks' performance

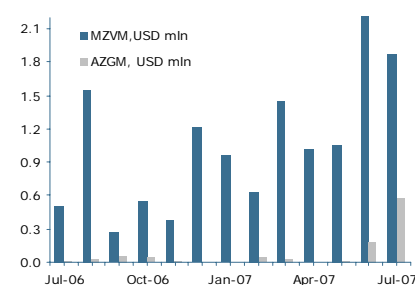


Source: PFTS

Sector performance, YTD



Trading volume, USD mln



Market multiples

	Mcap USD mln	Restated		EV/S		EV/EBITDA		P/E	
		2007E	2008E	2007E	2008E	2007E	2008E	2007E	2008E
Azovzahalmash	198.6	0.6	0.5	17.6	15.5	n/m	n/m		
Mariupol Heavy Machinery	241.6	0.5	0.5	29.9	29.0	n/m	n/m		

	Reported		P/E	
	2007E	2008E	2007E	2008E
AZGM	5.0	4.0	12	12
MZVM	4.7	4.1	15	13

Spot exchange rate: 5.05

Connected vessels

UPTK, the main private shareholder of the Azovmash Holding, has operating control in all four companies of the group. As Azovzahalmash and Mariupol Heavy Machinery are, technologically speaking, a single production complex, UPTK has certain leeway in selecting its primary revenue generator by channelling sales through one of the two companies.

The possible consolidation of the Avozmash group into a single company, we believe, is UPTK's primary mid-term target. Therefore, in terms of bargaining for a better share exchange ratio in the desired merger, UPTK has reason to be interested in boosting Azovzahalmash's value relative to Mariupol Heavy Machinery. At the same time, UPTK must take care to ensure that Mariupol Heavy Machinery's value is not destroyed: the state must receive fair treatment to bring about the merger.

Revenue re-distribution forecast

	2005	2006	2007E	2008E
AZGM	238	325	429	472
share in total	35.3%	39.3%	45.2%	46.8%
MZVM	436	502	521	536
Total	674	827	949	1,008

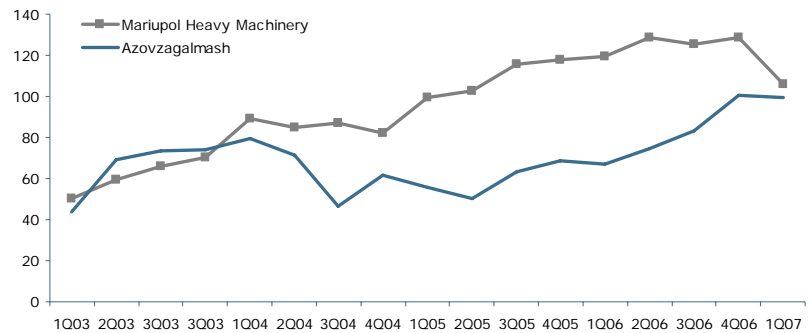
Source: Company data, Concorde Capital estimates

A merger could be reasonably expected in a two to three year period. In our opinion the most likely structure is that UPTK might agree to maintaining the existing ownership structure if they receive operating control over 25% of the state's stake in Azovmash Holding, as was the case during August 2003 to August 2005. Such a scenario might be of interest to the State as well, since consolidation provides an attractive opportunity to fill the budget by selling another 25% in Azovmash at a premium.

Hard statistics

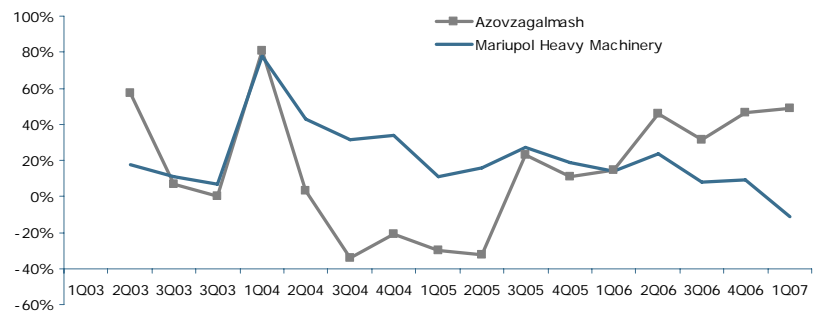
From June 2003 to March 2006, the state's 11% in Mariupol Heavy Machinery nearly found its way into UPTK's hands several times. During this period the State Property Fund announced several privatization tenders – only to later revoke them - while UPTK repeatedly stated its interest in acquiring the stake. After failure to strike a deal, it looks like UPTK focused on the preferential development of Azovzagalmash, where it is the controlling shareholder.

Quarterly sales, USD mln



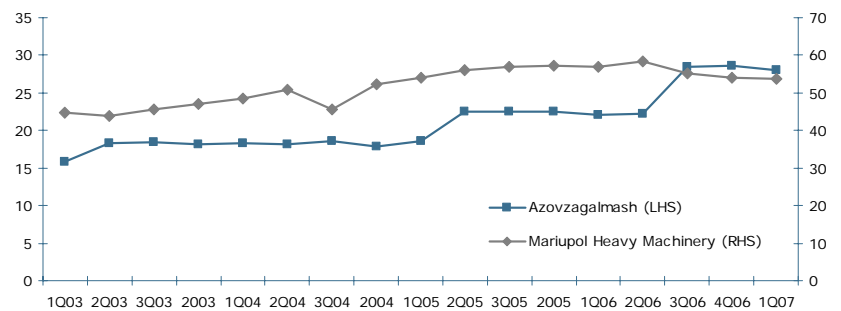
Source: Company data

Revenue growth, % qoq



Source: Company data

PP&E, USD mln



Source: Company data

Valuation

We compared the two companies to international railway and metallurgical machine-building companies.

Financial summary

	Country	Market Cap	Net Revenues, USD mln			EBITDA margin			Net Margin		
			2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E
MZVM		250	502	521	536	2.1%	1.8%	1.8%	0.0%	0.0%	0.0%
AZGM		182	325	429	472	3.0%	3.2%	3.3%	0.1%	0.2%	0.2%
American Railcar Industries	USA	875	646	763	986	10.6%	12.2%	12.1%	5.4%	6.2%	6.2%
Portec Rail Products	USA	128	99	109	115	10.3%	n/a	n/a	4.7%	5.4%	6.4%
Freightcar America	USA	616	1445	845	589	14.5%	8.3%	8.6%	8.9%	5.9%	4.8%
Greenbrier Companies	USA	462	954	1111	1197	11.7%	9.1%	11.2%	4.2%	0.5%	3.2%
Trinity Industries	USA	3565	3219	3474	3796	15.5%	15.9%	16.2%	6.7%	7.3%	7.7%
Const Y Auxiliat De Ferr	Spain	1149	1062	1196	1284	7.9%	6.7%	6.9%	4.3%	3.6%	3.8%
Kinki Sharyo Company Ltd	Japan	276	255	356	534	25.0%	24.4%	20.8%	10.6%	9.4%	10.0%
Bharat Earth Movers Limited	India	1156	462	n/a	n/a	15.8%	n/a	n/a	9.1%	n/a	n/a
Baotou Belfang Chuangye	China	154	160	n/a	n/a	3.5%	n/a	n/a	0.8%	n/a	n/a
Taiyuan Heavy Industry Co	China	992	441	n/a	n/a	6.0%	n/a	n/a	2.3%	n/a	n/a
Sandvic AB	Sweden	25671	10564	12140	13220	20.7%	21.1%	21.6%	10.7%	11.2%	11.5%
Japan Steel Works Limited	Japan	6004	1469	1837	1991	9.5%	17.3%	20.1%	3.8%	6.8%	7.5%
lochp-Maxion SA	Brazil	866	584	619	744	10.9%	14.0%	15.0%	4.6%	5.4%	7.2%
Peer average						12.4%	14.3%	14.7%	5.8%	6.2%	6.8%
	Country	Market Cap	EV/Sales			EV/EBITDA			P/E		
			2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E
International peers											
American Railcar Industries	USA	874.8	1.4	1.1	0.9	12.9	9.4	7.2	25.3	18.5	14.2
Portec Rail Products	USA	128.0	1.5	n/a	n/a	14.2	n/a	n/a	27.7	21.8	17.4
Freightcar America	USA	615.9	0.3	0.5	0.7	1.9	6.2	7.9	4.8	12.4	21.8
Greenbrier Companies	USA	462.1	0.7	n/a	n/a	6.3	n/a	n/a	11.7	85.3	12.1
Trinity Industries	USA	3,565.3	1.4	n/a	n/a	8.9	n/a	n/a	16.5	14.0	12.2
Const Y Auxiliat De Ferr	Spain	1,149.4	1.2	0.8	0.7	15.0	11.9	10.6	25.2	26.6	23.5
Kinki Sharyo Company Ltd	Japan	275.7	1.1	0.6	0.5	4.3	2.4	2.4	10.2	8.3	5.2
Bharat Earth Movers Limited	India	1,155.7	2.3	n/a	n/a	14.7	n/a	n/a	27.6	n/a	n/a
Baotou Belfang Chuangye	China	153.6	1.2	n/a	n/a	33.8	n/a	n/a	121.9	n/a	n/a
Taiyuan Heavy Industry Co	China	991.883	2.4	n/a	n/a	39.8	n/a	n/a	96.1	n/a	n/a
Sandvic AB	Sweden	25,670.9	2.6	2.3	2.1	12.7	11.1	9.8	22.8	19.0	16.9
Japan Steel Works Limited	Japan	6,003.7	4.3	3.3	3.1	44.8	19.0	15.2	107.6	47.8	40.2
lochp-Maxion SA	Brazil	866.2	1.6	n/a	n/a	14.6	n/a	n/a	32.0	26.0	16.2
Average			1.7	1.4	1.3	17.2	10.0	8.9	40.7	28.0	18.0
REPORTED DATA											
MZVM		250.2	0.6	0.5	0.5	30.0	4.7	4.1	2502	15	13
AZGM		181.9	0.7	0.6	0.5	23.8	5.0	4.0	909	12	12
Implied MZVM price, USD			50.7	46.9	44.3	7.6	4.1	3.6	0.26	0.19	0.13
Implied Upside (downside)			212%	189%	172%	-53%	-75%	-78%	-98%	-99%	-99%
Implied AZGM price, USD			10.67	12.03	12.17	2.54	1.66	1.67	0.18	0.52	0.36
Implied Upside (downside)			173%	208%	211%	-35%	-58%	-57%	-96%	-87%	-91%
MARGINS BENCHMARKED TO LOCAL PEERS											
MZVM		250.2	0.6	0.5	0.5	30.0	4.7	4.1	2502	15	13
AZGM		181.9	0.7	0.6	0.5	23.8	5.0	4.0	909	12	12
Implied MZVM price, USD			50.7	46.9	44.3	7.5	35.9	36.8	0.3	59.3	45.3
Implied Upside (downside)			212%	189%	172%	-51%	131%	137%	-98%	282%	192%
Implied AZGM price, USD			2.5	9.1	10.1	2.54	9.15	10.13	0.2	16.4	13.4
Implied Upside (downside)			-35%	134%	159%	-35%	134%	159%	-96%	319%	242%

Source: Bloomberg, Company data, Concorde Capital estimates

Local peer financial summary

	Country	Market Cap USD mln	Net Revenues, USD mln			EBITDA margin			Net Margin		
			2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E
Stakhaniv Wagon Works	Ukraine	87.2	90.5	156.7	187.1	7.5%	10.7%	11.7%	2.4%	5.9%	6.6%
Dniprovaogonmash	Ukraine	123.5	96.0	136.8	164.1	7.4%	10.0%	13.0%	2.8%	5.0%	7.0%
Kryukiv Wagon	Ukraine	317.9	225.4	340.6	391.0	13.1%	13.3%	13.5%	8.1%	8.2%	8.4%
Average						6.6%	7.8%	8.6%	2.7%	3.9%	4.4%

Source: Company data, Concorde Capital estimates

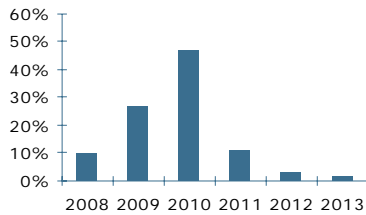
We employ a probabilistic approach to establish target prices for the two stocks (please refer to our September 2005 and December 2006 reports for explanation of the methodology).

The stocks' current market price can be considered as an interplay between conservative investors that are treating the situation "as is" (artificial, under-stated margins persisting) and optimists that are factoring real economics into their valuations.

We assume the most hardened pessimists look at EV/EBITDA using reported margins. For optimists, we suggest benchmarking the two companies' margins taken to the local peer group, and what different multiples imply.

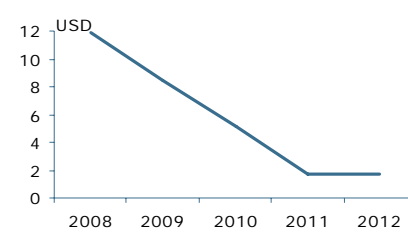
The earlier an investor expects transparency, the higher price they are willing to pay now. Successful merger negotiations might become a catalyst for opening the company's real economics to shareholders, but we do not expect talks to materialize sooner than in two years.

Probability of becoming transparent in a given year

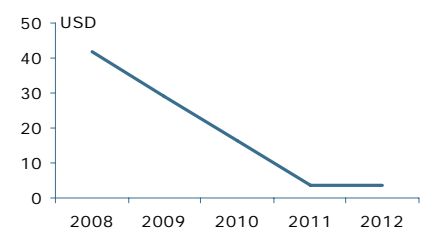


Target accepted by the market depending on when transparency starts

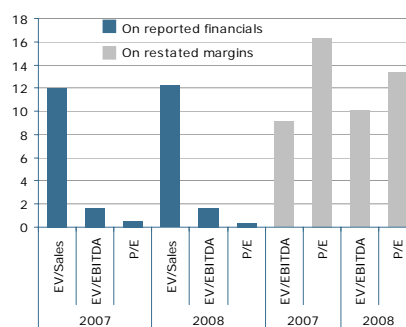
AZGM



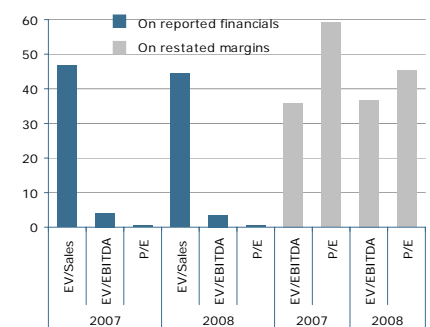
MZVM



AZGM implied prices, USD



MZVM implied prices, USD



Source: Concorde Capital research

Azovzahalmash

Income statement summary, USD mln

	2003	2004	2005	2006	1Q07
Net Revenues	260.6	258.2	238.1	324.9	99.5
<i>Change y-o-y</i>		-0.9%	-7.8%	36.4%	48.8%
Gross Profit	30.7	21.8	21.1	24.3	6.3
EBITDA	17.4	4.6	8.9	9.7	2.0
<i>margin, %</i>	6.7%	1.8%	3.7%	3.0%	2.0%
Depreciation	(1.3)	(1.4)	(1.5)	(1.7)	(1)
EBIT	16.2	3.2	7.3	8.0	2
<i>margin, %</i>	6.2%	1.2%	3.1%	2.5%	1.5%
Interest Expense	(0.0)	(1.3)	(3.0)	(6.0)	(1.5)
Other income/(expense)	0.0	0.0	0.0	0.1	0.1
PBT	16.2	2.0	4.4	2.1	0.1
Tax	(7.8)	(1.9)	(3.3)	(1.9)	-
<i>Effective tax rate</i>	48.0%	98.3%	74.5%	91.0%	0.0%
Net Income	8.4	0.0	1.1	0.2	0.1
<i>Net Margin, %</i>	3.2%	0.0%	0.5%	0.1%	0.1%

Balance sheet summary, USD mln

	2003	2004	2005	2006	1Q07
Current Assets	55.2	64.5	87.8	115.2	130.7
Cash & Equivalents	0.8	0.3	8.8	0.8	2.3
Trade Receivables	18.0	22.1	23.2	52.3	48.3
Inventories	15.6	15.9	28.8	42.6	50.2
Other	20.9	26.2	27.0	19.5	30.0
Fixed Assets	21.6	22.5	27.3	34.0	35.0
PP&E, net	18.2	17.8	22.5	28.6	28.0
Other	3.4	4.7	4.8	5.4	7.0
Total Assets	76.9	87.0	115.1	149.2	165.7
Shareholders' Equity	23.8	24.0	26.4	26.6	26.7
Share Capital	2.2	2.2	2.3	2.3	2.3
Retained Earnings	13.5	13.6	15.5	15.6	8.6
Other	8.2	8.2	8.6	8.6	15.7
Current Liabilities	53.0	63.0	88.7	122.6	139.0
ST Interest Bearing Debt	9.6	24.7	35.9	49.7	65.7
Trade Payables	17.2	8.9	25.0	43.2	39.0
Other	26.1	29.3	27.8	29.7	34.3
LT Liabilities	0.0	0.0	-	-	-
LT Interest Bearing Debt	-	-	-	-	-
Other	0.0	0.0	-	-	-
Total Liabilities & Equity	76.9	87.0	115.1	149.2	165.7

Mariupol Heavy Machinery

Income statement summary, USD mln

	2003	2004	2005	2006	1Q07
Net Revenues	245.5	344.4	436.3	501.9	105.7
<i>Change y-o-y</i>		40.3%	26.7%	15.0%	-11.5%
Gross Profit	30.0	24.4	36.4	36.2	6.2
EBITDA	7.3	3.4	13.8	10.4	0.4
<i>margin, %</i>	3.0%	1.0%	3.2%	2.1%	0.4%
Depreciation	(3.8)	(2.1)	(3.0)	(3.5)	(0.9)
EBIT	3.5	1.3	10.8	6.9	(0.5)
<i>margin, %</i>	1.4%	0.4%	2.5%	1.4%	-0.5%
Interest Expense	(0.3)	(1.6)	(4.5)	(7.9)	(0.8)
Other income/(expense)	(0.3)	0.9	(1.3)	3.0	1.2
PBT	2.9	0.6	4.9	2.0	-
Tax	(2.8)	(0.5)	(2.6)	-	-
<i>Effective tax rate</i>	97.2%	89.8%	52.5%	0.0%	-
Net Income	0.1	0.1	2.3	0.1	-
<i>Net Margin, %</i>	0.0%	0.0%	0.5%	0.0%	0.0%

Balance sheet summary, USD mln

	2003	2004	2005	2006	1Q07
Current Assets	111.8	137.5	158.1	181.5	133.6
Cash & Equivalents	2.6	0.3	0.6	0.4	0.4
Trade Receivables	27.6	26.2	56.5	79.7	44.0
Inventories	38.6	58.6	63.1	65.0	54.5
Other	43.0	52.5	38.0	36.5	34.7
Fixed Assets	65.3	69.4	71.0	65.5	64.6
PP&E, net	47.1	52.3	57.1	54.0	53.7
Other	18.2	17.0	13.9	11.5	10.8
Total Assets	177.0	206.9	229.2	247.0	198.2
Shareholders' Equity	71.0	66.0	70.4	65.5	65.2
Share Capital	0.7	0.7	0.8	0.8	0.8
Retained Earnings	17.4	24.0	26.6	28.7	28.4
Other	52.8	41.3	43.0	36.0	36.0
Current Liabilities	102.3	139.1	156.8	146.7	110.2
ST Interest Bearing Debt	5.0	19.2	53.2	13.8	8.5
Trade Payables	39.5	34.4	49.6	83.8	54.3
Other	57.8	85.5	54.1	49.2	47.4
LT Liabilities	3.7	1.7	2.0	34.8	22.7
LT Interest Bearing Debt	-	-	-	32.9	21.0
Other	3.7	1.7	2.0	1.9	1.7
Total Liabilities & Equity	177.0	206.9	229.2	247.0	198.2

Analyst certification

I, Inna Perepelytsya, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Azovzahalmarsh

Date	Target price, USD	Market Price, USD	Recommendation	Action
21-Sep-05	5.4	3.3	BUY	Initiating
06-Dec-06	2.1	2.5	HOLD	Downgrade
17-Jul-07*	6.1	4.3	BUY	Upgrade

* Until December 2006 the company was covered by Olha Pankiv, who now focuses on another sector. In July 2007, Inna Perepelytsya took over coverage.

Recommendation history, USD



Mariupol Heavy Machinery

Date	Target price, USD	Market Price, USD	Recommendation	Action
21-Sep-05	20.7	10.0	BUY	Initiating
06-Dec-06	12.1	8.9	BUY	Maintain
17-Jul-07*	20.3	15.7	BUY	Maintain

* Until December 2006 the company was covered by Olha Pankiv, who now focuses on another sector. In July 2007, Inna Perepelytsya took over coverage.

Recommendation history, USD



Concorde Capital Coverage Universe

Buy	33	39%
Hold	13	15%
Sell	5	6%
Under Review	24	28%
Not Rated	10	12%
Total	85	100%

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