



CONCORDE CAPITAL

# Ukraine / Chemicals

## Cherkasy Azot

### Pre-Wedding Makeup?

# BUY

15 June 06

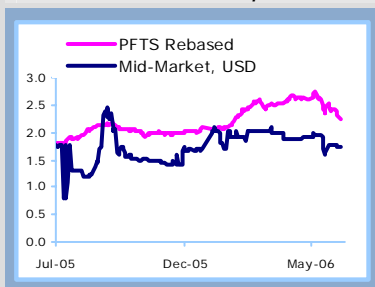
USD 2.2

12M Target

USD 3.0

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#### AZOT Mid-Market, USD



#### Market Information

Bloomberg AZOT UZ  
XETRA A9T GR

No of Shares\*, mln 124.3  
Reg S GDR to Ord. 1:30

\* including 3 additional share issues over 2004-2005

Market price\*, USD 2.2  
52Wk H/L, USD 2.4/0.8  
MCap, USD mln 273.4  
Free Float, % 3.0%  
FF, USD mln 8.2

\* the price is indicative, due to low liquidity of the stock, and may be affected by deal volume and transaction cost

#### Stock Ownership\*

Uksrib Group 80%  
Kliringoviy Dom 17%  
Minorities 3%

\* including 3 additional share issues over 2004-2005. See the report for details

#### Ratios 2005\*

EBITDA Margin 31%  
EBIT Margin 29%  
Net Margin 21%

Net Debt/Equity 0.03

\* based on adjusted financials

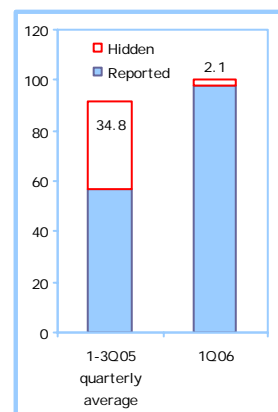
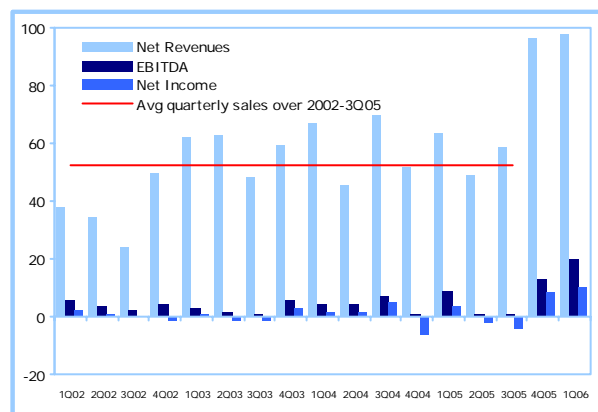
Outstanding sales and profitability figures for 1Q06 point to termination of creative accounting at Cherkasy Azot (AZOT). This is exactly what we expected to happen - the improvement was factored in our target price. Still, we consider the company's risks too high to upgrade valuation and maintain our recommendation (BUY) and the target (USD 3.0) unchanged.

#### Hidden Sales Now Visible

According to preliminary data, in 1Q06 AZOT boosted its quarterly sales by 54.6% yoy, from USD 63.4 mln in the 1Q05 to USD 98.0 mln in 1Q06.

The company's sales were driven by neither fertilizer prices nor output growth. We believe the growth resulted from the removal of tolling schemes with related parties, through which the company channeled about 1/3 of its exports in the past.

#### Quarterly Sales Dynamics, USD mln



Source: Company data, Concorde Capital estimates

#### Margins Unveiled

Although the first sign of higher transparency appeared in 4Q05 when quarterly sales surged 85.5% yoy, the margins were still low.

In the 1Q06, the company revealed its true profitability and demonstrated its highest EBITDA and net margins ever: 20.2% and 10.8% respectively, which is close to our 2006 forecast of 17.4% and 10.7%. We believe 1Q06 margins adequately reflect the true profitability of the company's business, which is now much closer to its Ukrainian peers.

#### KEY FINANCIAL DATA\*, USD mln

	Net Revenue	EBITDA	Net Income	DPS, USD
2004E	281.0	66.0	42.1	0.000
2005E	367.2	114.7	77.5	0.000
2006F	362.8	63.0	38.7	0.000

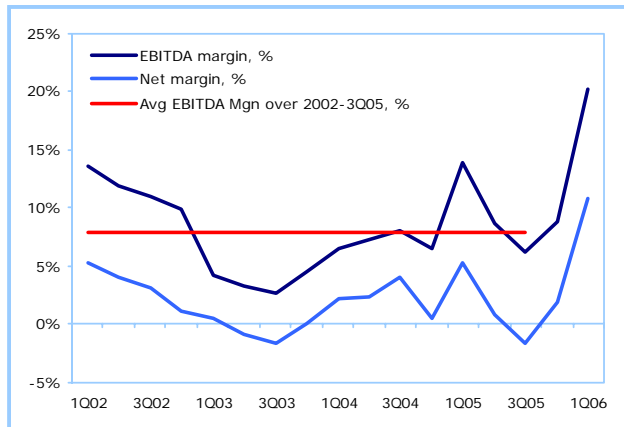
Spot Exchange Rate 5.05

\* based on adjusted financials

#### KEY RATIOS\*

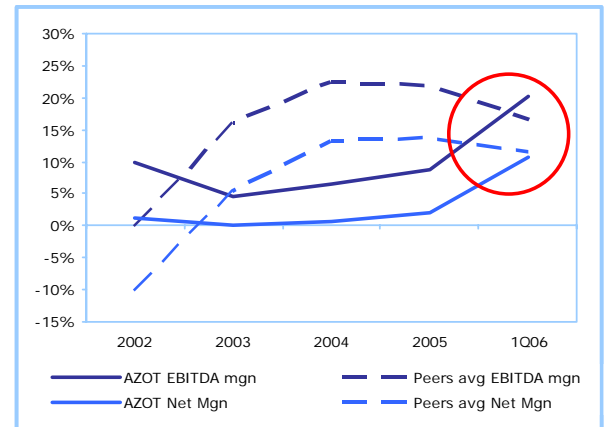
	P/S	P/E	EV/EBITDA	Div Yield
2004E	0.77	5.11	3.71	0.0%
2005E	0.59	2.77	1.92	0.0%
2006F	0.59	5.55	3.30	0.0%

**AZOT's Profitability**



Source: Company data, Concorde Capital estimates

**Margins Get Closer To The Peer's**



Source: Company data, Concorde Capital estimates

**Looking To Sell Out**

We believe that one of the main reasons the company decided to come out of the shadows was preparation for selling out. Provided the new owner can supply cheaper gas, AZOT will benefit from cost advantages over the other Ukrainian plants.

**The Gas Tycoon – An Ideal Suitor**

We believe Dmitry Firtash (45% owner of Ukraine's largest gas supplier, RosUkrEnergo) is the most likely candidate to buy AZOT. We feel that the company's recent failure to hold an EGM (see our ANB from May 22, 2006) and intensified blackmailing activity by AZOT's second largest shareholder, Kliringoviy Dom, were not just coincidences and were somehow related to Firtash bidding for Ukrсіб's stake.

Dmitry Firtash is said to have close ties to AZOT's shareholder, Kliringoviy Dom. The buyout of Ukrсіб's stake by Dmitry Firtash is well in line with the recent announcements about a planned consolidation of his fertilizer assets in FSU. That would make AZOT Firtash's fourth asset in FSU nitrogen fertilizer industry, in addition to Ukrainian Rivneazot, TajikAzot (Tajikistan) and Nitrofert (Estonia).

**Valuation: Target Unchanged - Risks Too High**

Despite positive developments in AZOT's financials, we consider risks too high to upgrade our target price. Thus, we stick to our recommendation (**BUY**) and target price (USD 3.0 per share).

*Risk Of Slipping Back Into The Shadows.* Even if the company is bought out and gets relatively cheaper gas, the new owner may be motivated not to disclose AZOT's true gas cost, so as to avoid anti-dumping sanctions initiated by its rivals. The new owners may just turn back to good old tolling schemes and thus hide true gas costs for AZOT.

*Legal Risk.* Recently the Kyiv Economic Court ruled in favor of Kliringoviy Dom. According to the decision, the share issue from July 2004, resulting in a ~3x build-up of share capital, was declared illegal. In effect, the two consequent issues were deemed illegal as well, as those were approved with a number of votes including the former issue. Should superior courts approve this ruling, the shareholders will probably have to sell back their shares at par. However, we believe the risk is unlikely to materialize in the foreseeable future, as the ruling is hardly enforceable and consequent appeals will prolong the legal proceedings for years. For the purpose of valuation we take the number of shares registered with the State Securities And Exchange Commission, including all three share issues over 2004-2005.

*Risk Of Higher Gas Prices.* According to our most recent forecast, the yearly average gas price for industrial consumers will reach USD 143/thr cm this year (transportation and delivery cost included), 13% above our previous forecast. That would squeeze the company's margins. However, AZOT is better diversified than its Ukrainian rivals and can weather gas price hike relatively better. Based on EBITDA, its estimated break-even gas price is more than USD 180/thr cm, provided ammonia price do not fall below USD 220/mt.

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