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Analyst's Notebook

Ukraine / Chemicals
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Cherkasy Azot in Deadlock.

The conflict between the shareholders of Cherkasy Azot (**AZOT: Susp**) has escalated to the point that it creates excessive risks for trading or holding the company's stock, in our view. We therefore suspended our coverage pending the resolution of the conflict (see our Alert of Sept. 8).

AZOT's main minority shareholder group, whose 28% blocking stake was diluted to 11% in the course of three successive share issues during 2004-2006, has strengthened its position after two recent rulings: one by the Kyiv Economic Court invalidating AZOT's share register, and another by the Higher Economic Court declaring all three share issues illegal.

Although the rulings will be appealed, there is a high risk that they will eventually come into force. As a result, the State Securities And Exchange Commission (SSEC) could cancel the additional share issues and restore the company's share register as of June 26, 2004. Portfolio investors who bought shares after that date could be struck from the register, and in general there would be confusion surrounding the ownership of shares, which could make it impossible to sell the shares until the confusion could be sorted out.

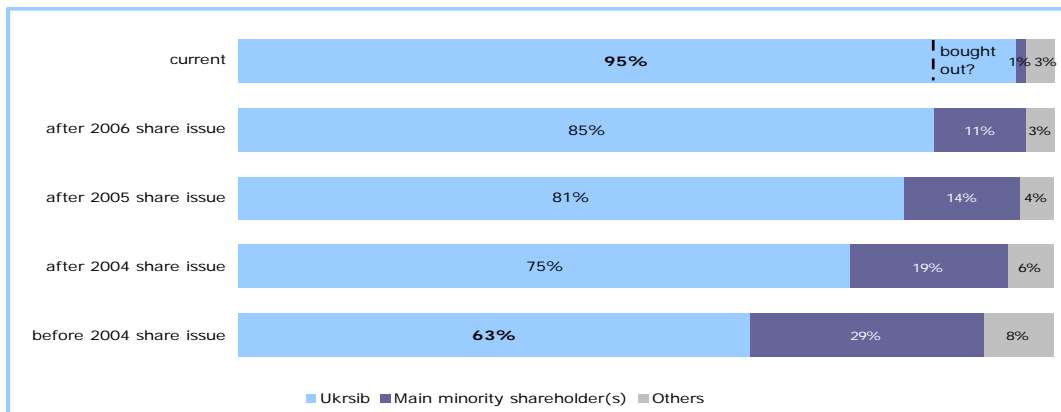
Prelude to a Takeover?

It looks like AZOT's main minority shareholder is putting pressure on the main shareholder, the Ukrсіб group, to sell the company. It is also possible that the minority shareholder's goal is simply to sell its stake at a favorable price, but we think that is less likely, as the minority shareholder group has apparently already sold most of its diluted stake to Ukrсіб.

This follows from a close inspection of the company's reports of large shareholders since 2004. Prior to the first of the share issues in 2004, the minority shareholder group owned about 28.5% of AZOT's shares. If the group had retained those shares, and not subscribed to any of the three share issues, its stake after dilution would now be about 11%. However, the latest official report of AZOT's shareholders shows the Ukrсібgroup with a 95% stake. Also, the minority group recently disclosed to the media that its stake does not exceed 2%.

The minority shareholder group's apparent move to sell down its stake does not conflict with our conclusion that it the group is probably targeting full control, as even a tiny stake enables it to continue putting pressure on Ukrсіб through the courts. Why Ukrсіб agreed to buy only a portion and not the whole minority stake is unclear.

History Of AZOT's Shareholder Structure



Source: Concorde Capital estimates

Firtash Likely to be Behind the Minorities

There have long been rumors that Dmytro Firtash, the Moscow-based Ukrainian tycoon who owns 45% of RosUkrEnerg, is behind Cherkasy Azot's main minority shareholder group. Firtash is a major player in Ukraine's chemicals industry with controlling stakes in Crimean Soda (KSOD) and Rivneazot (RAZT). Firtash's partnership with Gaprom, which owns 50% of RosUkrEnerg, and the latter's monopoly role in Ukraine's gas imports makes him a very powerful man in Ukraine, especially in relation to the chemicals industry.

Our investigation found evidence supporting the view that Firtash is probably behind AZOT's minority shareholder group, but no conclusive proof. One of the main players in the minority group was a Ukrainian investment company called Financial Company Kliringovy Dom. In 2004, prior to the completion of AZOT's first share issue, FC Kliringovy Dom acquired a 16.3% stake in AZOT from a subsidiary of Naftogaz. FC Kliringovy Dom said at the time it was cooperating with and also representing the interests of another AZOT shareholder, Pearlman Enterprises (Virgin Islands), which owned 12.2% of AZOT's shares. In late 2004 Kliringovy Dom disposed of its 11.1% diluted stake to another off-shore company, Visalot Limited (Bahamas).

Earlier, in 2003, FC Kliringovy Dom won a privatization tender for a controlling stake in Crimean Soda, which it resold to RSJ Erste Beteiligungsgesellschaft, a German-registered company associated with Firtash. According to FC Kliringovy Dom's filings, as of the end of 2005 it owned 15.5% of the Ukrainian company Zangas-NGS, which is apparently a subsidiary of the Russian company Zangas, which is controlled by Firtash. One of FC Kliringovy Dim's managers is a relative of one of the managers of the bank Kliringovy Dom, which is part-owned by Ivan Fursin, who is a partner of Firtash and owns 5% of RosUkrEnerg.

Pearlman and Visalot are still AZOT's shareholders and together they hold slightly more than 1% (estimated) of AZOT's shares. It is they who are currently suing AZOT in the courts.

History of the Conflict

On Aug. 1, the Higher Economic Court ruled that AZOT's last three share issues were illegal. The decision followed a two-year saga of corporate conflicts between AZOT's main minority shareholder and the majority owner, Ukrsib group.

On Aug. 3, the minority shareholder won another court battle, increasing its chances to win the war. The Kiev Economic Court ruled that Cherkasy Azot's shareholder register was invalid since June 26, 2004. According to the ruling, from then AZOT's registrar, the

Ukraine Energy Company, was simultaneously also a shareholder, which is illegal. The court's ruling was not publicly disclosed until Sept. 8, when we issued our alert and suspended coverage of AZOT. The ruling would have come into force from Aug. 13 if Cherkasy Azot had not appealed. According to the company, it did appeal.

Conflict History Sheet

April 23, 2004	AGM approves 49% increase in shareholder capital , from 49.0 mln shares to 73.1 mln shares. Subscription period (1 st stage): Jun 1 – Jun 16, 2004. Quorum: 91.84%, out of which 68.68% voted positively. FC Kliringovy Dom (KD) becomes a shareholder (it bought 16.3% from Gaz Ukrayiny). The parties signed an agreement on April 22, 2004, but it became effective after the April 23 AGM
July 16, 2004	PFTS temporarily suspends listing AZOT
July 29, 2004	The issue is registered by the SSEC KD appeals to the Cherkasy Court Of Appeal and files suit in the Kyiv Economic Court
Oct. 11, 2004	The Kyiv Economic Court declares the additional issue illegal and rules that the registration must be cancelled by the SSEC. AZOT appeals to the Kyiv Court of Appeal
Nov. 11, 2004	KD obtains a ruling in its favor from the Cherkasy Court Of Appeal. AZOT says the court ruling was falsified and obtains a letter from the court supporting its position. KD says its court ruling is legitimate and AZOT's letter has no legal power
Dec. 8, 2004	The Kyiv Court of Appeal confirms the decision of the Kyiv Economic Court invalidating the additional share issue
 Dec. 28, 2004	 AZOT's AGM approves another share issue, increasing the number of shares by 35% , from 73.1 mln to 98.4 mln. Quorum: 75.3%, out of which 99.97% voted positively. Subscription period (1 st stage): Jan. 17 – Feb. 1, 2005. KD says it will appeal
Dec. 30, 2004	The Higher Economic Court cancels the rulings of the Kyiv Economic Court and the Kyiv Court of Appeal, which had declared the share issue of April 2004 illegal
March 2005	Supreme Court rejects KD's appeal of the Higher Economic Court ruling
July 11, 2005	SSEC registers the second share issue
July 2005	PFTS resumes listing of AZOT stock
 Nov. 11, 2005	 AZOT's AGM approves another share issue, increasing the number of shares by 26% , from 98.4 mln to 124.3 mln. Subscription period (1 st stage): Dec. 12 – Dec. 27, 2005. Quorum: 94.1%, out of which 100% voted positively.
Jan. 10, 2006	SSEC registers third share issue
May 12, 2006	The Kyiv Economic Court declares all three share issues illegal. The suit was brought by Pearlman Enterprises.
June 21, 2006	The Kyiv Court Of Appeal cancels the decision of the Kyiv Economic Court
July 12, 2006	The Prosecutor General's Office initiates an investigation into the legality of AZOT's privatization and asks the State Property Fund (SPF) to perform a retrospective valuation of the company.
Aug. 1, 2006	The Higher Economic Court rules that all three share issues were illegal
Aug. 3, 2006	The Kyiv Economic Court rules that AZOT's share register is invalid
Aug. 9, 2006	The SPF concludes that AZOT's privatization was in conformity with the law

Note: For the sake of brevity, only the most important events are included.

Source: Interfax, Ukrainian News agency, Investgazeta, Delo, Delovaya Stolitsa, State Securities and Exchange Commission.

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