

BUY

12M Target USD 0.19

Alexander Viktorov

+380 44 207 50 37
av@concorde.com.ua

Market Information

Bloomberg	BAVL UZ
No of Shares, mln	20,099
Market price, USD	0.164
MCap, USD mln	3,296
Free float	6.5%
FF MCap, USD mln	214

Stock Ownership

Raiffeisen International	93.5%
Ukrtelecom	0.7%
Bank Austria Creditanstalt	0.5%
Other	5.3%

Ratios, 2006E

Net Interest Margin	7.3%
Net Margin	19.1%
ROE	24.3%
Cost/Income	56.8%

Raiffeisen Bank Aval's 9M06 earnings were higher than we expected thanks to stronger lending growth, a resilient net interest margin and improved cost efficiency. Over the next twelve months, at least, we see growth above the market average and a buoyant ROE, due to increasing retail penetration and an ongoing cost-improvement program. The upcoming 70% capital increase can become another catalyst for the stock. We reiterate our BUY recommendation and upgrade the 12-month target to USD 0.19.

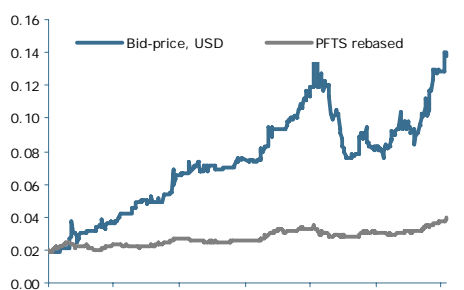
Retail Drives Growth and Profitability. Retail loans, which surged 194% yoy, was the main lending growth driver. As of the end of September, retail accounted for 47% of the overall loan book against 29% the year before. The almost doubling of higher-yield retail loans was reflected in the net interest margin improving to 6.7%, compared with 5.9% in 9M05. We believe Aval's retail expansion, sustainable in medium-term, will support NIM above 7% over 2006-08, despite an overall lower interest rate environment.

Cost Efficiency Is In The Works. Aval's Cost/Income ratio fell in 9M06 to 59%, an all-time low, as operating expenses dropped 2% yoy. Cost cuts of USD 35 mln were achieved as the bank was getting rid of its ownership of numerous non-core businesses, reducing unreasonably high overheads. Raiffeisen's strategy foresees making Aval the processing center for the group in Eastern Europe, which entails bringing the bank's cost efficiency up to the parent's level. We see further cost improvements over the next 24 months.

The "ROEest" Bank in Ukraine. Stronger NII performance and lower operating costs reflected in the 9M06 earnings of USD 63 mln came in above our expectations. While still awaiting full year results, we upgrade our net income forecast for 2006 by 16% to USD 88 mln. Implied 2006 ROE amounts to 24% - the highest among Ukrainian banks.

70% Share Capital Increase. We consider the USD 297 mln (+70%) capital increase, expected in 2Q07, an important short-term catalyst for the stock. If placed at par, the new share issue will offer an opportunity to reduce the average cost of investment into the stock by subscribing for cheap shares. Aval's shareholders will continue to enjoy high ROE, due to the bank's strong earning power.

BAVL Stock Performance



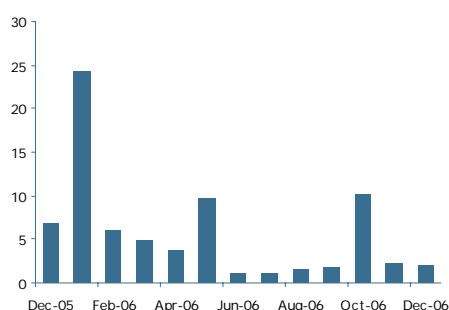
Source: PFTS

Key Financials, USD mln

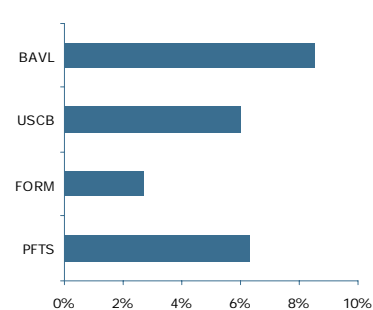
	Assets	Loans	Deposits	Equity
2006E	5,518	4,396	3,260	458
2007E	7,993	6,638	4,521	858
2008E	11,306	9,535	6,449	1,232

Spot exchange rate: 5.05

Trading Volume, USD mln



Sector Performance, YTD



Price Ratios

P/E	P/BV	P/Assets	P/Loans	P/Deposits
37.5	7.2	0.6	0.7	0.7
20.5	5.3	0.4	0.5	0.7
12.5	3.7	0.3	0.3	0.5

Estimates Revised Upward

Full-year financial results are still awaited. However, based on the latest available data for 9M06, we adjusted key financial estimates for the bank. We increased our 2006 and 2007 net income forecast by 15.8% and 22.9% respectively, with a ROE at 24% in 2006-07 – the highest on the market. The upward revision is largely a function of stronger net interest income (NII) growth and lower operating expenses.

At the same time, we trim our assumptions on deposit growth and now look for 15% yoy and 38.5% yoy growth in 2006 and 2007, instead of 17.5% yoy and 40% yoy previously forecast.

Projections Revision Summary

	9M06	2006E			2007E		
		Prev.	New	% change	Prev.	New	% change
Net loans	3,951	3,776	4,396	16.4%	5,709	6,638	16.3%
Corporate	2,169	2,019	2,332	15.5%	2,499	2,886	15.5%
Retail	1,949	2,023	2,305	13.9%	3,606	4,108	13.9%
Total assets	4,985	5,148	5,518	7.2%	7,139	7,993	12.0%
Customer deposits	2,936	3,321	3,260	-1.8%	4,599	4,521	-1.7%
Corporate	991	1,139	1,078	-5.4%	1,466	1,388	-5.3%
Retail	1,945	2,182	2,182	0.0%	3,133	3,133	0.0%
Net interest income	194	259	283	9.3%	419	464	10.7%
Total income	326	440	464	5.5%	650	685	5.4%
Operating expenses	193	273	264	-3.3%	385	368	-4.4%
Operating income	133	169	200	18.3%	267	317	18.7%
Net income	63	76	88	15.8%	131	161	22.9%

Source: National Bank of Ukraine, Concorde Capital estimates

Upcoming 70% Capital Increase – a Catalyst

In November 2006, the bank announced plans to increase its equity capital by USD 297 mln (+70%) through an additional issue of 1,500 mln shares. However, at its EGM on Dec. 22, 2006, the share emission was put off until the next AGM in the spring of 2007, because the issue was not fully paid in by then (as of December 29 though 100% of the shares had been paid in full).

The issue will provide the bank with funding power for asset growth, while Aval's strong income generation ability defends shareholders against diminishing the bank's superior ROE. We expect 2007 ROE to remain unchanged at 24%, as 2007 estimated net income growth of 82% will match the rate of equity increase.

Should the issue be conducted, as usual, at par value (USD 0.198), the participation in the subscription for additional shares, warranted at pro rata, will offer an opportunity for shareholders to reduce the average cost of their investment into the stock. Amendments to the number of tax laws that came into force since Jan. 1, 2007 enables *market* share issuance, meaning that new shares are sold at the market price rather than at par, with no tax obligations for the issuer. We have not seen any new share placements in accordance with new regulations yet, and it is not clear when *market* placements will begin in Ukraine.

Valuation Update

Peer Comparison

	Country	MCap, USD mln	P/E		P/B		P/Operating profit	
			2007E	2008E	2007E	2008E	2007E	2008E
Raiffeisen Bank Aval	Ukraine	3,296	20.5	12.5	5.3	3.7	10.4	6.9
CEE PEERS								
PKO BP	Poland	14,897	23.0	20.8	4.7	3.7	18.0	16.3
Pekao SA	Poland	12,265	22.7	21.9	4.1	3.7	18.0	15.2
Bank BPH	Poland	8,843	22.9	20.9	3.8	3.6	15.3	14.0
OTP	Hungary	11,643	12.3	11.1	3.2	3.0	10.2	9.2
Komerční Banka	Czech Rep	5,785	15.0	14.1	3.2	2.6	11.4	10.6
Yapi Kredi Bank	Turkey	5,162	9.9	8.1	3.6	2.9	8.3	6.8
Sberbank	Russia	65,375	29.4	24.2	5.4	4.2	22.4	18.4
CEE peers' average			19.3	17.3	4.0	3.4	14.8	12.9
Premium/(Discount)			6%	-28%	32%	10%	-30%	-46%
Implied Price, USD			0.15	0.23	0.12	0.15	0.23	0.31
Upside/(Downside)			-6%	38%	-24%	-9%	42%	86%

UKRAINIAN PEERS								
Ukrsotsbank	Ukraine	1,739	21.5	15.5	4.5	3.5	13.2	9.4
Forum	Ukraine	732	20.6	10.7	4.2	3.7	9.7	7.3
Megabank	Ukraine	121	41.1	27.4	4.0	3.7	25.0	18.2
Rodovid Bank	Ukraine	281	60.0	43.3	6.2	4.5	27.4	19.5
Ukrainian peers' average			35.8	24.2	4.7	3.9	18.8	13.6
Premium/(Discount)			-43%	-48%	11%	-4%	-45%	-49%
Implied Price, USD			0.29	0.32	0.15	0.17	0.30	0.32
Upside/(Downside)			75%	93%	-10%	4%	81%	96%

	Country	MCap, USD mln	P/Assets		P/Loans		P/Deposits	
			2007E	2008E	2007E	2008E	2007E	2008E
Raiffeisen Bank Aval	Ukraine	3,296	0.4	0.3	0.5	0.3	0.7	0.5
CEE PEERS								
PKO BP	Poland	12,437	0.4	0.4	0.6	0.5	0.5	0.5
Pekao SA	Poland	11,114	0.5	0.5	1.0	0.7	0.7	0.5
Bank BPH	Poland	8,253	0.4	0.7	0.7	0.5	0.5	0.5
OTP	Hungary	9,648	0.3	0.3	0.5	0.3	0.5	0.4
Komerční Banka	Czech Rep	5,803	0.3	0.2	0.6	0.4	0.3	0.3
Yapi Kredi Bank	Turkey	5,859	0.2	0.2	0.3	0.2	0.3	0.3
Sberbank	Russia	41,990	0.3	0.3	0.4	0.3	0.4	0.3
CEE peers' average			0.34	0.35	0.6	0.4	0.5	0.4
Premium/(Discount)			30%	9%	23%	4%	93%	57%
Implied Price, USD			0.14	0.20	0.19	0.20	0.10	0.12
Upside/(Downside)			-16%	22%	16%	23%	-37%	-24%

UKRAINIAN PEERS								
Ukrsotsbank	Ukraine	1,739	0.4	0.3	0.4	0.3	0.5	0.4
Forum	Ukraine	732	0.4	0.3	0.4	0.3	0.4	0.3
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Rodovid Bank	Ukraine	281	0.4	0.3	0.6	0.5	0.7	0.5
Ukrainian peers' average			0.40	0.30	0.5	0.4	0.6	0.4
Premium/(Discount)			3%	-3%	-5%	-14%	28%	19%
Implied Price, USD			0.16	0.17	0.17	0.19	0.13	0.14
Upside/(Downside)			-3%	3%	6%	16%	-22%	-16%

Source: Concorde Capital estimates, Merrill Lynch, Bloomberg

DDM Model

Our revised DDM model yields a fair twelve-month price for BAVL stock of USD 0.18 per share, implying a 25% upside.

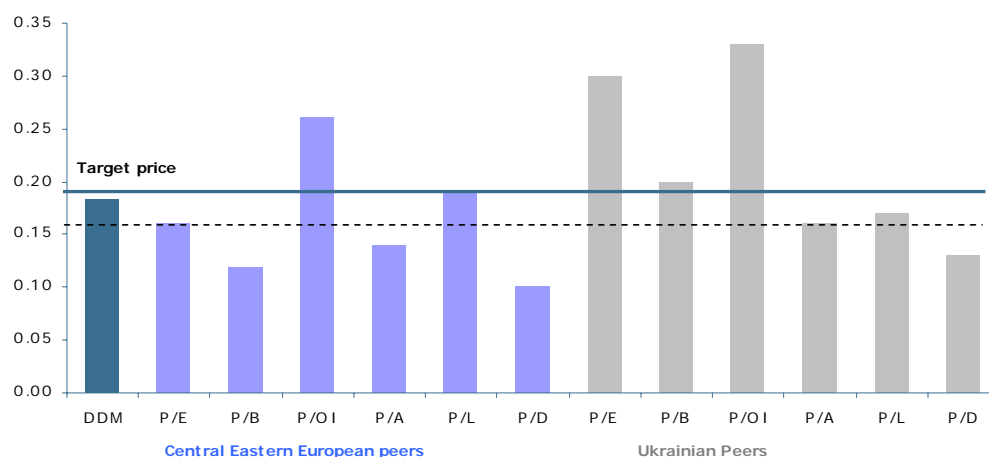
DDM valuation summary; benchmarking to Total CAR of 12%, UAH ths

	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Target Total Capital	2,883,281	4,313,735	6,160,796	8,339,665	10,502,551	12,844,347	15,500,803	18,474,347	21,639,078	25,113,615
CAR	12%	12%	12%	12%	12%	12%	12%	12%	12%	12%
Cash flow	(125,646)	838,795	435,830	540,709	1,002,652	1,404,820	641,424	947,615	1,403,969	1,889,046
Discount rate	13%	12%	11%	11%	11%	11%	10%	10%	10%	10%
Discounted CF	(111,751)	752,421	390,951	436,839	729,768	921,154	378,908	508,762	685,247	838,185
Valuation date		18-Jan-07	18-Jan-08							
Terminal Value		11,011,864	12,333,288					Discount Rate to Perpetuity		10.0%
Equity Value, UAH ths		16,130,189	18,065,811					Perpetuity Growth Rate		3.0%
per Share		USD 0.16	USD 0.18					Imlied Exit P/E Multiple		x5.7

We set the 12-month target at USD 0.19, in between what our DDM model suggests and the average implied by Ukrainian peers. Valuations in Ukraine remain at premium to CEE peers: 18% (14%) on P/B 2007 (2008) and reach as high as 85% on P/E 2007. We treat this cross-market premium as justified, due to a stage of active expansion where Ukrainian banks will remain in the mid-term, unlike their CEE peers.

We thus see an upside of at least 16%, though strong market momentum can easily bring the stock price up to top valuation levels (USD 0.20 and above).

Valuation Summary



Strong Lending Growth

The third quarter brought further acceleration in lending, with incremental volume of USD 801 mln (gross loan), compared to USD 555 mln in 2Q06.

An overall advance in the bank's loans over 9M06 significantly beat the market average: 62% ytd versus 48%. Retail lending was the main driver and advanced by 125% ytd to USD 1.95 bln (vs. a market average of 86%). Corporate loans grew in line with market by a healthy 31% ytd to USD 2.17 bln. Based on the National Bank's statistics, we estimate that Aval's market share in total loans increased to 10% from 9% last year. The bank's market share in retail also strengthened to 16% against 13% in 9M05, preserving Aval's position as #2 retail lender in Ukraine.

The achieved growth prompted us to upgrade our 2006 loan portfolio forecast by 16.4% to USD 4.39 bln, as a result of upwardly revised estimates for corporate (up 15.5% to USD 2.33 bln) and retail (up 13.9% to USD 2.3 bln) lending.

Bank Aval: Loan Book and NIM Development

	1Q05	1H05	9M05	2005	1Q06	1H06	9M06
Gross loan portfolio	1,643	1,979	2,267	2,539	2,762	3,318	4,118
% chg, YTD	8%	30%	49%	67%	9%	31%	62%
Retail	401	492	664	853	1,030	1,441	1,949
% chg, YTD	11%	36%	83%	136%	21%	69%	129%
Corporate	1,242	1,487	1,604	1,686	1,732	1,877	2,169
% chg, YTD	-1%	19%	28%	35%	3%	11%	29%
Retail/Total loans	24%	25%	29%	34%	37%	43%	47%
Interest earn. assets/Total assets	79%	81%	86%	79%	87%	90%	89%
Net interest margin	5.9%	5.8%	5.9%	6.7%	6.9%	6.8%	6.7%

Source: National Bank of Ukraine, Concorde Capital

Higher-Margin Retail Drives Net Interest Income

Aval delivered strong 9M06 net interest income (up 69% yoy to USD 194 mln), which was boosted by healthy growth in lending volume and higher margins. Despite overall lower interest rates (the average market lending rate was 14.3% in 9M06 against 14.6% in 9M05), Aval's reported 9M06 NIM stood at 6.7% compared to 5.9% in the same period last year. The main reasons for margin gains were:

1. *Improving asset mix.* The share of interest earning assets in the bank's balance sheet increased to 89% from 86% the year before. The growth was driven by solid loan expansion, as the portion of loans among Aval's total interest earning assets rose to 93% from 78%;
2. *Higher portion of retail.* Aval continued to shift aggressively into the higher-return retail segment. As of the end of September, retail loans accounted for 47% of the bank's overall loan book versus just 29% in 9M05;

Aval will continue to build a more retail-oriented loan portfolio. The management's goal is to become Ukraine's largest retail lender by 2009. We expect retail loans to reach 65% of the overall loan book over the next two years. We believe further expansion into retail is a reliable way to sustain the bank's margins in a lower interest rate environment. Our 2006 estimates changed only slightly as we now expect a NIM of 7.3% against 7.0% expected previously.

At the same time, we slightly downgrade our NIM forecast for 2007 from 7.9% to 7.7% to reflect the risk to the bank's margin from the cost of the deposit side. The Loans-to-Deposits (LTD) ratio deteriorated noticeably from 1.0 at the beginning of 2006 to 1.4 by the end of the year (sector average of 1.2), due to the outflow from the corporate segment, which the bank saw early in 2006. While the bank has managed to offset the reduced deposit base via additional share capital and increased foreign borrowings, we do not exclude that they will become more aggressive in attracting customer funds.

Cost Optimization Is In The Works

Having cleaned up Aval's loan book, Raiffeisen set out to put Aval's expenses in order. Aval was the only bank in Ukraine's stock universe that had a declining trend in the cost line over the year. Nine-month operating expenses dropped 2% yoy to USD 193 mln - contrary to the market, which posted a 37% yoy increase. 18% of total economy in costs was due to a USD 35 mln cut in other operating expenses (down remarkable 52% yoy).

This item, which previously accounted for more than one-third of the bank's total costs was reduced to 16%. This was achieved as over 2005-2006, the bank disposed of several non-core businesses that inflated its cost line.

Businesses disposed of in 2005

	Stake, %	USD ths*
OJSC "Metalconstruction plant"	34.3%	1,000
CJSC "Proftaxi"	75.0%	479
CJSC "Pyriatynsky Cheese Plant"	50.0%	443
CJSC "Khmelnyske taxi"	75.1%	387
CJSC "Vinnytsa taxi park"	75.2%	375
CJSC "Kievskiy Zavod Shampanskikh Vin "Stolychnyy"	50.0%	58
Total		2,742

* value of the stake as reported in balance sheet

Source: Ernst & Young, news agencies

Raiffeisen's strategy foresees making Aval the processing center for the group in Eastern Europe, which entails bringing the bank's cost efficiency up to the parent's level. We see further cost improvements over the next 24 months.

9M06 Results at a Glance

Bank Aval: Quarterly Results

	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	9M06
Net interest income	34	36	45	51	49	65	81	194
% chg. yoy					42%	79%	81%	69%
Net fee & commission income	25	30	33	123	31	37	42	109
% chg. yoy					22%	22%	26%	24%
Net non interest income	33	38	42	158	39	44	49	132
% chg. yoy					19%	17%	18%	18%
Total income	67	74	86	324	87	109	130	326
% chg. yoy					31%	47%	50%	44%
Operating expenses	59	68	66	262	60	63	70	193
% chg. yoy					1%	-8%	6%	-0.4%
Operating income	8	6	21	62	28	46	60	134
% chg. yoy					255%	723%	191%	294%
Net income	0.7	0.6	0.6	1.8	10	27	26	63
% chg. yoy					1260%	4227%	4116%	3108%
Gross loan portfolio	123	336	289	2,539	223	555	801	4,118
% chg. yoy				67%	81%	65%	177%	82%
Customer's deposits	383	428	307	3,003	(186)	54	65	2,936
% chg. yoy					-149%	-87%	-79%	8%
Cost/income	88.4%	92.4%	76.2%	80.8%	68.4%	57.6%	53.9%	59.0%
Loan/deposit	82%	82%	83%	85%	98%	116%	140%	140%
ROE (annualised)					6.4%	13.3%	19.1%	19.1%

Source: National Bank of Ukraine, Concorde Capital

Bank Aval vs. Domestic Traded Banks

	Assets			Corporate loans		Retail loans		Customer deposits	
	Mkt share	USD mln	YTD, %	USD mln	YTD, %	USD mln	YTD, %	USD mln	YTD, %
Raiffeisen Bank Aval	8.8%	4,985	31%	2,169	31%	1,949	125%	2,936	-2%
Ukrsotsbank	4.9%	2,815	32%	1,029	22%	1,098	86%	2,041	23%
Bank Forum	2.0%	1,138	53%	678	67%	140	113%	659	45%
Ukrghazbank	1.2%	672	31%	246	18%	85	194%	399	31%
Rodovid bank	0.9%	511	41%	217	4%	124	186%	322	24%
Megabank	0.3%	192	19%	111	29%	26	94%	138	11%
Ukrinbank	0.3%	163	16%	105	35%	27	96%	110	-6%

Source: National Bank of Ukraine, Concorde Capital

Bank Aval vs. Domestic Traded Banks (cont'd)

	Net interest income		Net Fee & Commission		Total Revenues		Operating Expenses		Net Income		Net margin
	USD mln	chg. yoy	USD mln	chg. yoy	USD mln	chg. yoy	USD mln	chg. yoy	USD mln	chg. yoy	
Raiffeisen Bank Aval	194	66%	109	22%	326	42%	(192.6)	-2%	63	3064%	19%
Ukrsotsbank	83	72%	56	20%	155	44%	(92.0)	19%	44	222%	29%
Forum	30	59%	7	69%	40	65%	(29.4)	102%	4	8%	11%
Ukrghazbank	16	39%	7	32%	29	34%	(23.4)	55%	4	199%	13%
Rodovid bank	7	93%	7	154%	17	110%	(11.4)	134%	3	112%	18%
Megabank	5	25%	7	13%	13	18%	(9.7)	11%	2	91%	12%
Ukrinbank	7	47%	4	24%	14	30%	(11.3)	21%	1	59%	10%
All banks	1,842	70%	1,036	46%	3,294	54%	(1,903)	37%	593	103%	18%

Source: National Bank of Ukraine, Concorde Capital

Financial Summary

All financial statements were prepared according to IFRS, USD mln

	2005	2006E	2007E	2008E	2009E	2010E
Profit and Loss						
Net interest income	165	283	475	687	876	1,067
Net commissions income	121	148	184	249	333	428
Trading income	30	32	37	45	56	69
Total income	317	464	696	982	1,266	1,565
Operating income	105	200	328	480	618	755
Net income	14	88	161	266	353	442
Profit and Loss Growth						
Net interest income	62%	72%	68%	45%	27%	22%
Net commissions income	4%	23%	24%	35%	34%	29%
Trading income	25%	5%	15%	23%	24%	22%
Total income	30%	47%	50%	41%	29%	24%
Operating income	45%	92%	64%	46%	29%	22%
Net income	-57%	525%	82%	65%	32%	25%
Balance Sheet						
Net Loans	2,354	4,396	6,638	9,535	12,918	16,232
Corporate loans	1,660	2,332	2,886	3,463	4,052	4,660
Retail loans	868	2,305	4,108	6,573	9,532	12,391
Average interest earning assets	2,331	3,893	5,996	8,668	12,009	15,667
Total Assets	3,706	5,518	7,993	11,306	15,360	19,425
Customer deposits	2,827	3,260	4,521	6,449	8,931	11,356
Corporate deposits	1,003	1,078	1,388	1,749	2,116	2,497
Retail deposits	1,824	2,182	3,133	4,700	6,815	8,859
Average interest bearing liabilities	2,725	4,235	6,016	8,521	11,769	15,333
Book Value	270	458	858	1,232	1,672	2,164
Balance Sheet Growth						
Net Loans	57%	87%	51%	44%	35%	26%
Corporate loans	32%	40%	24%	20%	17%	15%
Retail loans	140%	166%	78%	60%	45%	30%
Average interest earning assets	44%	67%	54%	45%	39%	30%
Total Assets	73%	49%	45%	41%	36%	26%
Customer deposits	78%	15%	39%	43%	38%	27%
Corporate deposits	61%	7%	29%	26%	21%	18%
Retail deposits	89%	20%	44%	50%	45%	30%
Average interest bearing liabilities	49%	55%	42%	42%	38%	30%
Book Value	65%	69%	87%	44%	36%	29%
Key Ratios						
Non interest income/Total income	41.9%	52.1%	61.0%	68.2%	70.0%	69.2%
Net interest income/Total income	58.1%	47.9%	39.0%	31.8%	30.0%	30.8%
Net interest margin	7.1%	7.3%	7.9%	7.9%	7.3%	6.8%
Net income margin	4.5%	19.1%	23.1%	27.1%	27.9%	28.2%
Provision/Operating income	71.5%	44.8%	36.0%	30.7%	28.6%	26.9%
Cost / Income ratio	67.0%	56.8%	52.9%	51.2%	51.2%	51.8%
ROA	0.5%	1.9%	2.4%	2.8%	2.6%	2.5%
ROE	6.5%	24.3%	24.5%	25.5%	24.3%	23.0%

Source: Company's data, Concorde Capital estimates

Concorde Capital
3V Sportyvna Square
2nd entrance, 3rd floor
Kyiv 01023, UKRAINE

Tel: +380 44 207 5030
Fax: +380 44 206 8366
www.concorde.com.ua
office@concorde.com.ua

CEO

Igor Mazepa

im@concorde.com.ua

Head of Equity Sales

Lucas Romriell

lr@concorde.com.ua

Equity Sales

Marina Martirosyan
Anastasiya Nazarenko

mm@concorde.com.ua
an@concorde.com.ua

Director of Research

Konstantin Fisun, CFA

kf@concorde.com.ua

Utilities (Telecom, Energy)

Alexander Paraschiy

ap@concorde.com.ua

Metals & Mining

Andriy Gostik
Eugene Cherviachenko

ag@concorde.com.ua
ec@concorde.com.ua

Machine Building, Construction, Consumer Goods

Olha Pankiv

op@concorde.com.ua

Financial Services & Macroeconomics

Alexander Viktorov

av@concorde.com.ua

Oil & Gas, Chemicals

Vladimir Nesterenko

vn@concorde.com.ua

Fixed Income

Oleksandr Klymchuk

ok@concorde.com.ua

News/Production

Nick Piazza
Polina Khomenko

np@concorde.com.ua
pk@concorde.com.ua

Editor

Brad Wells

bw@concorde.com.ua

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