



CONCORDE CAPITAL

Ukraine / Steel

DMK Dzerzhinskogo

Capital injection to fuel growth

March 18, 2008

Current price: USD 0.61
12M Target : USD 1.00

BUY

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DMK Dzerzhinskogo's AGM today voted on a 1.4x charter fund increase. The company is two years into a five-year USD 1 bln modernization program, which will allow it to achieve 60% output growth targeted by 2011. This build-up has been overlooked by the market – the stock currently trades at a discount to its peers on all multiples. Fundamentals bode well: global steel prices, following the uptrend in iron ore, have grown 50% since last March. We initiate coverage with a BUY and target of USD 1.00 (upside 64%).

Tickers

Bloomberg DMKD UZ

Market information

Market price, USD 0.61
(fully diluted) 0.29

MCap, USD mln 1,698.9

Chg 12M 168.7%

Hi/Lo 12M, USD 0.772/0.198

No of shares, mln 2,776.5

New no of shares, mln 6,776.5

Avg Mon Tr Vol 12M, USD mln 0.482

Free float 0.9%

Free float, USD mln 15.87

Shareholders

IUD 99.1%

Other 0.9%

AGM voted on capital injection to fund modernization

Shareholders of DMK Dzerzhinskogo Steel today voted on a 144% charter fund increase to USD 0.2 bln via an additional share issue. The company will place 4,000 mln shares at par value, USD 0.05.

	# of shares	Charter fund, USD mln
Current	2,776.5	137.45
Additional issue	+4,000.0	+198.02
After issue	6,776.5	335.47

Subscription will run from May 12 to December 5, 2008 with the ex-rights date on May 9. Proceeds will be directed to funding the modernization program to boost output.

60% output growth targeted by 2011

DMK Dzerzhinskogo plans to boost crude steel output by 59% to 6.0 mln mt by 2011 (from 3.8 mln mt in 2007), chief engineer Volodymyr Romanenko told a Ukrainian trade publication in late February. The mill is two years into a five-year USD 1 bln modernization program designed to expand capacity; we estimate the company has spent USD 0.3 bln since 2005. By way of modernization, the mill will improve energy efficiency and boost its share of higher value added products, particularly with regard to rolled section steel.

Opportunity for up to 50% arbitrage profit⁽¹⁾ over eight month period

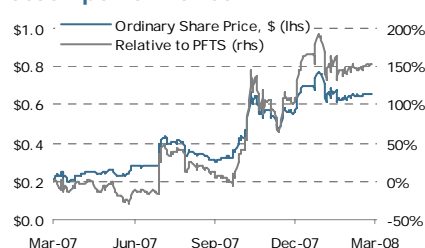
The share issue will be held at par value, USD 0.05. Based on the current market price (USD 0.64), the required adjustment to a fully-diluted basis (USD 0.29) is 55%. Analysis of historical data on deeply discounted share issues with a required price correction of this magnitude suggests an arbitrage profit of 50%.

Target price set at USD 1.00, 64% upside

We set our target price at USD 1.00 per share, based on comparative valuation. The implied upside of 64% is the largest in the Ukrainian metals & mining stock universe. DMKD's liquidity has vastly improved over the last 12 months, with spreads contracting from 30% to 6%. We initiate coverage with a BUY rating.

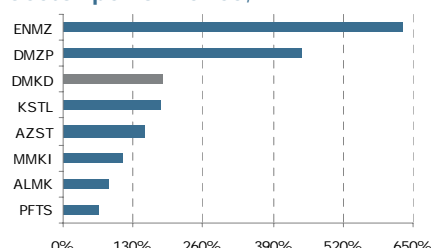
⁽¹⁾ see our report of February 21, 2008 for a comprehensive discussion of the concept.

Stock performance

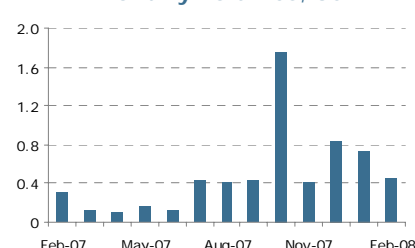


Source: Bloomberg, PFTS

Sector performance, 12M



DMKD monthly volumes, USD mln



Key financials & ratios, USD mln

	Revenue	EBITDA	Net Income	EBITDA Mgn	Net Mgn	EV/S	EV/EBITDA	P/E
2006	1,139.5	148.5	88.9	13.0%	7.8%	1.6	12.1	19.1
2007E	1,520.0	205.2	106.4	13.5%	7.0%	1.3	9.9	17.8
2008E	2,356.0	353.4	188.5	15.0%	7.5%	0.9	5.8	9.4

Spot exchange rate: 5.05 UAH/USD

Source: Company data, Concorde Capital estimates

Valuation

We value DMKD by applying a multiples based analysis to Ukrainian, International and Russian peers. Our valuation implies a range for DMKD's fair value of USD 0.7-1.5 per share. We set our 12M target price at USD 1.00.

EV/S 2008	
Implied by Ukrainian peers	1.16
Implied by International peers	1.21
Implied by Russian peers	1.47
EV/EBITDA 2008	
Implied by Ukrainian peers	0.80
Implied by International peers	0.76
Implied by Russian peers	0.67
EV/output 2008	
Implied by Ukrainian peers	0.99
Target price	1.00

	MCap, USD mln	EV/S		EV/EBITDA		P/E		EV/output	
		<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>
DMKD	1,698.9	1.3	0.9	9.9	5.8	17.8	9.4	0.55	0.53
Ukrainian Peers		<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>
Arcelor Mittal Kriviy Rih	14,473.1	4.1	3.5	14.0	12.2	19.4	18.6	1.75	1.71
Azovstal	4,404.0	1.5	1.2	6.8	5.5	10.3	8.6	0.72	0.72
Alchevsk Iron & Steel	1,131.4	1.1	0.7	8.3	5.0	15.3	7.8	0.44	0.29
Enakievo Steel	878.3	1.0	0.8	6.5	4.7	11.8	8.1	0.33	0.30
DMZ Petrovskogo Steel	712.0	1.4	1.2	6.5	5.5	6.6	5.6	0.61	0.63
MMK Illich Steel	4,333.7	1.2	1.1	7.0	6.7	10.4	9.5	0.60	0.60
Average		1.7	1.4	8.2	6.6	12.3	9.7	0.74	0.71
International Peers		<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>		
Gerdau	18,796.1	1.2	1.1	5.7	4.9	9.6	8.2		
Usinas Sider Minas	19,356.3	2.3	2.1	6.5	5.8	10.5	9.7		
Cia Siderurgica Nacional	28,012.0	3.8	3.3	8.4	7.0	15.6	12.1		
Posco	38,935.8	1.5	1.4	5.5	5.2	9.2	8.8		
Nippon Steel Corp	32,775.6	0.9	0.8	5.3	5.3	9.5	9.9		
Tata Steel Limited	11,504.8	0.8	0.7	5.2	4.4	5.3	4.7		
China Steel Corp	17,462.2	2.5	2.3	7.8	7.4	10.6	10.1		
Baoshan Iron & Steel	35,115.3	1.5	1.3	7.9	6.8	17.2	14.2		
Angang Steel	19,509.4	2.2	1.7	8.7	6.9	16.1	13.7		
Maanshan Iron & Steel	5,918.3	1.3	1.0	9.3	7.5	18.3	14.9		
Hyundai Steel	5,657.6	1.0	1.1	8.3	8.6	9.4	9.4		
Nucor Corp	19,713.9	1.1	0.9	6.3	5.2	11.7	11.1		
Average		1.7	1.5	7.1	6.3	11.9	10.6		
Russian Peers		<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>	<i>2007E</i>	<i>2008E</i>		
Severstal	23,227.5	1.5	1.3	5.7	4.7	11.5	9.9		
Novolipetsk Steel	23,853.0	3.1	2.7	6.7	5.5	10.6	9.2		
Nizhny Tagil Ferrous Metals	3,038.0	0.9	0.8	3.3	2.3	6.5	5.0		
Mechel	16,338.6	2.6	2.0	9.7	8.8	18.2	14.4		
Magnitogorsk	14,191.4	1.7	1.5	5.6	5.6	7.8	8.2		
Evrast Group	28,571.7	2.7	2.3	7.9	6.3	12.2	10.8		
Average		2.1	1.8	6.5	5.5	11.1	9.6		
DMKD price									
Implied by Ukrainian Peers avg, USD/share		0.90	1.16	0.57	0.80	0.47	0.66	0.97	0.99
Implied by Intern. peers avg, USD/share		0.89	1.21	0.48	0.76	0.46	0.72		
Implied by Russian peers avg, USD/share		1.11	1.47	0.44	0.67	0.43	0.65		
Upside/Downside to Ukrainian avg		47%	90%	-7%	31%	-23%	8%	59%	62%
Upside/Downside to Intern. avg		45%	98%	-21%	24%	-25%	17%		
Upside/Downside to Russian avg		81%	139%	-28%	9%	-30%	6%		

DMK Dzerzhinskogo reported financials, UAS

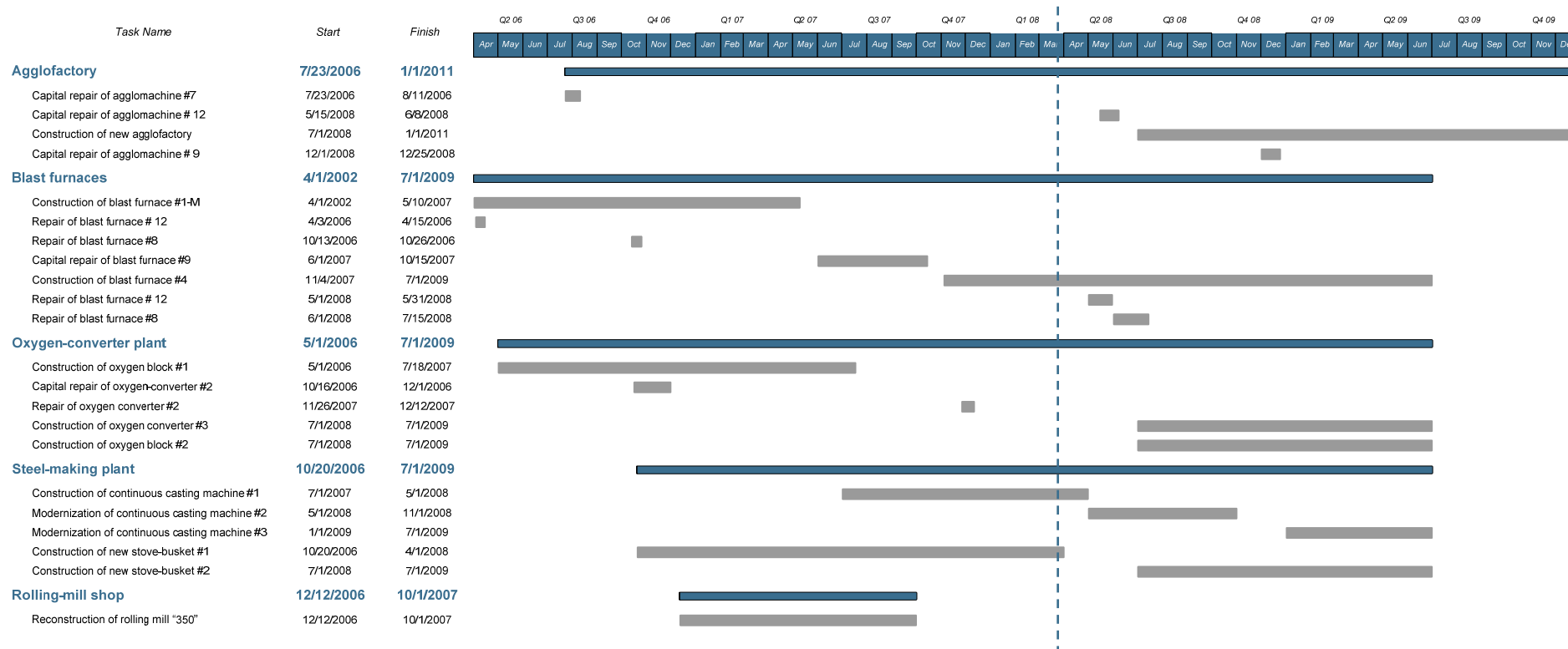
Income statement summary, USD mln

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Net Revenues	223.1	310.7	334.8	270.8	362.8	351.4	399.6
Cost Of Sales	(188.7)	(247.1)	(272.8)	(233.8)	(299.1)	(286.8)	(326.7)
Gross Profit	34.5	63.6	61.9	37.0	63.7	64.6	72.9
<i>Gross margin</i>	<i>15.4%</i>	<i>20.5%</i>	<i>18.5%</i>	<i>13.7%</i>	<i>17.6%</i>	<i>18.4%</i>	<i>18.3%</i>
Other Operating Income/Costs, net	10.3	2.2	3.0	19.9	2.2	3.8	3.3
SG&A	(19.5)	(20.0)	(24.0)	(20.5)	(22.9)	(20.9)	(24.4)
EBITDA	25.2	45.8	41.0	36.5	43.0	47.6	51.9
<i>EBITDA margin</i>	<i>11.3%</i>	<i>14.7%</i>	<i>12.2%</i>	<i>13.5%</i>	<i>11.8%</i>	<i>13.5%</i>	<i>13.0%</i>
Depreciation	(3.6)	(3.7)	(4.0)	(4.2)	(4.1)	(4.3)	(4.4)
EBIT	21.6	42.1	37.0	32.3	38.8	43.3	47.5
<i>EBIT margin</i>	<i>9.7%</i>	<i>13.5%</i>	<i>11.1%</i>	<i>11.9%</i>	<i>10.7%</i>	<i>12.3%</i>	<i>11.9%</i>
Interest Expense	(1.6)	(2.3)	(2.1)	(2.3)	(1.7)	(3.4)	(2.6)
Financial income/(expense)	0.0	0.0	0.0	0.0	0.0	(0.0)	-
Other income/(expense)	(2.7)	(1.6)	(1.9)	(3.7)	(1.6)	(1.7)	(2.3)
PBT	17.3	38.2	33.1	26.3	35.5	38.2	42.5
Tax	(3.6)	(7.5)	(10.7)	(4.2)	(7.1)	(7.4)	(8.4)
Net Income	13.7	30.6	22.4	22.2	28.3	30.8	34.1
<i>Net Margin</i>	<i>6.2%</i>	<i>9.9%</i>	<i>6.7%</i>	<i>8.2%</i>	<i>7.8%</i>	<i>8.8%</i>	<i>8.5%</i>

Balance sheet summary, USD mln

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07
Current Assets	373.6	359.9	337.6	375.2	380.8	341.7	400.6
Cash & Equivalents	0.5	1.3	4.2	0.3	0.6	0.1	0.3
Trade Receivables	85.4	101.5	93.7	18.6	69.1	51.7	59.1
Inventories	145.3	141.0	134.6	180.0	174.7	222.8	252.2
Other current assets	142.4	116.1	105.1	176.4	136.5	67.1	89.1
Fixed Assets	340.4	357.5	351.5	377.6	427.5	457.7	480.0
PP&E, net	166.0	166.5	168.0	180.0	183.4	187.1	190.9
Other Fixed Assets	174.3	191.0	183.5	197.6	244.1	270.7	289.1
Total Assets	714.0	717.4	689.1	752.8	808.4	799.4	880.6
Shareholders' Equity	361.8	401.4	403.9	427.7	434.8	463.2	482.5
Share Capital	137.5	137.5	137.5	137.5	137.5	137.5	137.5
Reserves and Other	169.8	169.7	176.7	177.5	176.5	176.3	175.8
Retained Earnings	54.5	94.2	89.8	112.7	120.9	149.4	169.2
Current Liabilities	272.9	259.1	228.2	272.6	301.2	264.0	325.8
ST Interest Bearing Debt	19.1	38.9	34.9	51.6	50.3	41.4	35.6
Trade Payables	116.7	116.0	105.0	143.1	173.2	131.4	149.3
Accrued Wages	3.3	3.4	3.4	3.5	5.6	3.6	3.7
Accrued Taxes	4.2	4.8	11.5	3.3	5.8	5.3	8.4
Other Current Liabilities	129.6	96.0	73.4	71.1	66.4	82.4	128.8
LT Liabilities	79.2	56.9	56.9	52.5	72.3	72.3	72.3
LT Interest Bearing Debt	76.2	56.7	56.7	52.2	72.2	72.2	72.2
Other LT	3.0	0.2	0.2	0.3	0.1	0.1	0.0
Total Liabilities & Equity	714.0	717.4	689.1	752.8	808.4	799.4	880.6

Appendix 1. DMK Dzerzhinskogo modernization projects



Source: Company data, Concorde Capital estimates

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.

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Buy	49	44%
Hold	30	27%
Sell	18	16%
Under Review	15	13%
Total	112	100%

Investment banking clients*

Buy	6	86%
Hold	0	0%
Sell	0	0%
Under Review	1	14%
Total	7	100%

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