

# Dniproenergo, Zakhidenergo

## Privatization edges closer

### Zakhidenergo announcement due in August, DNEN in Sept

The State Property Fund is due to announce Zakhidenergo's privatization next month and Dniproenergo's sale in September. We still hold that both are likely to finally be sold off this year. Neither Centrenergo nor Donbasenergo are on the table now and we do not expect the government to move those stakes before 2013.

### No short-term turnaround after privatization

Privatization is likely lead to short-term price volatility, if the government's sale of electricity distribution companies is a guide. However, we do not view privatization as a price driver, primarily because we expect sale prices to be low due to a lack of competition. We also believe it will not be a profitability driver as improved margins are a function of significant CapEx (roughly equal to current market capitalization), which is unlikely immediately following privatization.

### Dniproenergo fundamentally superior to Zakhidenergo

Between Dniproenergo and Zakhidenergo, we prefer the former due to its superior asset quality and ability to earn relatively strong margins even in the current environment. Zakhidenergo, meanwhile, is only roughly breaking even on EBITDA (lower efficiency, longer distance to coal mines) and we see its place in DTEK's value chain as a coal consumer rather than profit center.

### Low liquidity in both names

Dniproenergo is illiquid and Zakhidenergo is only marginally better: respective average monthly trading volumes were USD 0.4 mln and USD 2.2 mln during last year, and we estimate total free float at USD 14.4 mln and USD 25.1 mln.

### Valuation: BUY DNEN and HOLD ZAEN

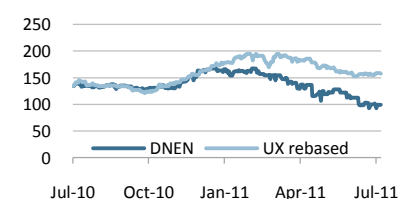
Even after assigning a 40% discount for illiquidity to Dniproenergo, it remains attractively priced at current levels. We rate it BUY with target price of USD 156 per share (58% upside). Dniproenergo is the only GenCo that has the potential to generate significant cash on its balance sheet and become a dividend play. At the same time, we downgrade Zakhidenergo to HOLD with target price of USD 47 per share (20% upside).

Report date	28 July 2011
Bloomberg	DNEN UK
Reuters	DNEN=UA
<b>Recommendation</b>	<b>BUY</b>
Price (28 July 11), USD	98.8
12M price target, USD	155.6
Upside	58%

No of shares, mln	5.9
Market Cap, USD mln	589.5
52-week performance	12%
52-week range, USD	171.7/88.0
ADT, 12M, USD mln	0.1
Free float, %	2.45%
Free float, USD mln	14.4

Prices as of Jul. 28, 2011

#### Price performance



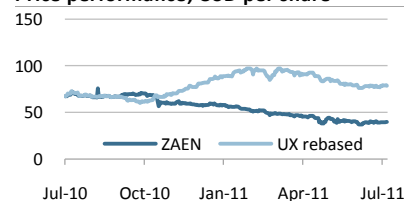
Source: Bloomberg, UX

Bloomberg	ZAEN UK
Reuters	ZAEN=UA
<b>Recommendation</b>	<b>HOLD</b>
Price (28 July 11), USD	39.42
12M price target, USD	47.4
Upside	20%

No of shares, mln	12.7
Market Cap, USD mln	503.6
52-week performance	4%
52-week range, USD	71.57/37.36
ADT, 12M, USD mln	1.4
Free float, %	5%
Free float, USD mln	25.1

Prices as of Jul. 28, 2011

#### Price performance, USD per share



Source: Bloomberg, UX

## Privatization saga close to culmination

### Zakhidenergo to get date in August, Dniproenergo afterward

The State Property Fund is due to announce Zakhidenergo's privatization next month and Dniproenergo's sale in September. We still hold that both are likely to finally be sold off this year.

### Prices to be low due to lack of competition

We do not see privatization as a price driver, because we expect sale prices to be low due to lack of competition. We base our view on the following reasons:

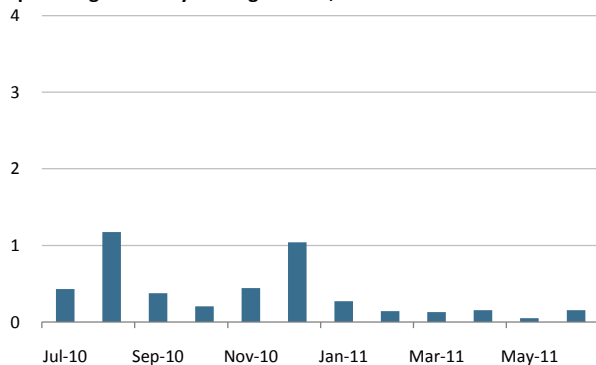
- The state is selling non-controlling stakes (25% in Dniproenergo and 45% in Zakhidenergo). We consider this potentially interesting only to DTEK, which as a current minority shareholder, could gain majority stake
- Electricity market regulation is far from being predictable and without significant reform interest from global players in the sector is limited

We also do not believe privatization will be a short-term profitability driver as improved margins are a function of significant CapEx (roughly equal to current market capitalization) and time necessary for modernization.

### Liquidity is low in both names

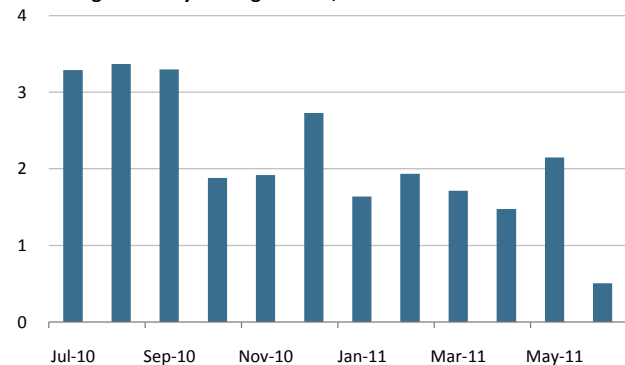
Dniproenergo is illiquid and Zakhidenergo is only marginally better: respective average monthly trading volumes were USD 0.4 mln and USD 2.2 mln during last year, and we estimate total free float at USD 14 mln and USD 25 mln.

Dniproenergo monthly trading volume, USD mln



Source: UX

Zakhidenergo monthly trading volume, USD mln



Source: UX

### No put option for minorities during privatization?

Though Ukrainian law provides for a put option for minorities to sell their stakes if a new majority shareholder appears, there is a potential loophole if the controlling stake is acquired via privatization. It is unclear whether a shareholder that purchases a minority stake during privatization and as a result increases their stake above the 50% threshold has to offer a put option to minorities. In lieu of an official interpretation from Ukraine's Securities and Exchange Commission, we recommend assuming a put option will not be offered.

### Centrenergo, Donbasenergo auctions: no earlier than 2013

Neither Centrenergo nor Donbasenergo are on the privatization table now and we do not expect the government to move those stakes before 2013. We believe this will give the government time to implement regulatory reforms and for sector profitability to turnaround, which should allow the state to fetch a higher price for these assets.

## Fundamentals favor Dniproenergo

### Dniproenergo is fundamentally superior to Zakhidenergo

Between Dniproenergo and Zakhidenergo, we prefer the former due to its superior asset quality and ability to earn relatively strong margins in the current challenging environment. Dniproenergo, Ukraine's largest traded GenCo by installed capacity, has the most efficient power units, which allow it to notch the sector's highest margins and enough cash flow to invest in asset modernization and thus further increase profitability. Zakhidenergo, meanwhile, is only roughly breaking even on EBITDA (lower efficiency, longer distance to coal mines) and we see its place in DTEK's value chain as a coal consumer rather than profit center.

#### Dniproenergo and Zakhidenergo comparison

	Dniproenergo	Zakhidenergo	GenCos average
EBITDA margin, 2010	10.4%	1.7%	4.8%
Capacity utilization, %, 2010	31%	29%	36%
Fuel consumption per kWh, g of fuel equiv., 2010	382	401	396
Coal-fired installed capacity, MW	5,785	4,400	4,275
Total installed capacity, MW	8,185	4,400	5,355
EV/ Capacity (coal-fired), USD per kW	123	132	108

Source: Company data, Concorde Capital

### CapEx requirements high for both names

Both Dniproenergo and Zakhidenergo's power plants require modernization. Analyzing the 19 modernization projects undertaken by Ukrainian GenCos in the last decade, we found CapEx to modernize a full unit was USD 175-254 per kW (to prolong the working life of the power unit by 15-20 years, reduce fuel consumption by 3-7% and increase the unit maneuverability range by twofold). This is notably lower than the USD 1,500-1,800 per kW required for construction of a new coal-fired power unit.

We estimate Dniproenergo's CapEx requirement (USD 175 per kW) to be lower than Zakhidenergo's (USD 254 per kW), because the former has larger-size power units that are cheaper to modernize in per kW terms.

#### CapEx needed to modernize all power units

	Modernized capacity, MW	Un-modernized capacity		CapEx, USD mln	CapEx, USD/kW
		Units less <280 MW	Units above >280 MW		
Dniproenergo	732	450	4,603	882	175
Zakhidenergo	185	2,415	1,800	1,071	254
<i>For comparison:</i>					
Centrenergo	300	1,050	3,225	856	200
Donbasenergo	210	1,600	800	647	269

Sources: Concorde Capital estimates

## Valuation

With regulatory reform widely accepted by market participants as necessary but not imminent, there is still little clarity on long-term electricity pricing and thus little meaning in any cash flow valuation model. We continue valuing GenCos via asset-based methods, a conservative approach, in our view.

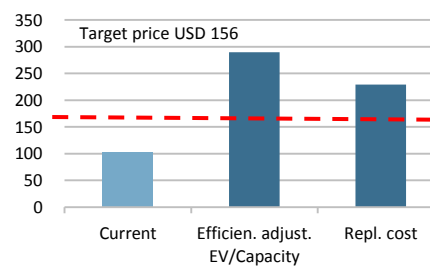
We average the results of a replacement cost model (which accounts for replenishment value adjusted for physical asset depreciation) and EV/Capacity comparison to Russian peers, with adjustments for relative efficiency (which we introduce in this report as both the Ukrainian and Russian market are sensitive to current profitability, a reflection of efficiency). We also assign respective discounts for Dniproenergo and Zakhidenergo of 40% and 20% due to their low liquidity.

### Valuation summary, USD per share

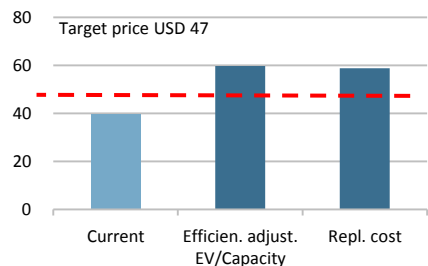
	Implied price per share			Target price	Current price	Upside	Rec.
	by EV/Capacity	by replacement cost	Liquidity discount				
Dniproenergo	290	229	-40%	155.6	98.8	58%	BUY
Zakhidenergo	59.7	58.7	-20%	47.4	39.4	20%	HOLD

Source: Bloomberg, Company data, Concorde Capital

Dniproenergo, USD per share



Zakhidenergo, USD per share



## Comparative valuation

We compare Dniproenergo and Zakhidenergo to peers by the EV/Capacity multiple, which reflects how the market values one unit of generation capacity (for Dniproenergo we take only coal-fired capacity, as gas-fired capacity is idle due to high gas prices).

Dniproenergo and Zakhidenergo are trading at USD 120 and 131 per kW of capacity, compared with USD 199-694 per kW for Russian peers and USD 700-1,500 per kW for global peers.

We consider comparison to Russian peers appropriate as we believe the huge upside relative to the EM peer group is not realizable over the medium term given the prohibitive regulatory environment in Ukraine.

However, we believe the discount to Russian peers based on EV/capacity could be justified only by liquidity, while fundamentals are quite balanced, in our view.

With this report we introduce efficiency discounts/premiums to the average capacity multiple to reflect the market's preference for GenCos with high fuel efficiency and profitability. Analyzing Russian OGKs' valuation range, we find less profitable GenCos are trading at 23% discounts to the harmonic mean EV/Capacity, while more profitable ones are priced at 76% and 162% premiums. We applied efficiency discounts/premiums as indicated in the table below to Ukrainian GenCos when calculating fair EV based on the Russian harmonic mean EV/Capacity to capture their relative efficiency.

### Comparative valuation summary

	Implied EV, USD mln	Efficiency premium/ (discount)	Implied EV adjusted for efficiency, USD mln	Implied MCap, USD mln	#shares, mln	Implied price per share, USD
Dniproenergo	1,466	25%	1,832	1,728	5.97	289.6
Zakhidenergo	1,118	-25%	836	763	12.79	59.7

Source: Company data, Bloomberg, Concorde Capital

### GenCo multiples

	EV/S		EV/EBITDA		EV/Capacity	EV/MWh
	2011E	2012E	2011E	2012E	coal-fired total capacity	USD per MWh
Dniproenergo	0.6	0.5	5.0	2.8	120	84.7
Zakhidenergo	0.7	0.5	17.3	7.7	131	131.0
<b>Ukraine GenCos harmonic mean</b>	<b>0.6</b>	<b>0.4</b>	<b>11.4</b>	<b>5.2</b>	<b>108</b>	<b>88.6</b>
OGK-1	0.8	0.7	4.6	4.2		182.9
OGK-2	0.9	0.8	6.5	5.9		212.4
OGK-3	1.1	0.9	13.5	6.5		206.2
OGK-4	3.3	2.5	12.3	7.6		693.3
Enel OGK-5	1.8	1.6	7.6	6.1		457.2
OGK-6	1.0	0.8	9.1	5.4		199.0
<b>Russian OGKs harmonic mean</b>	<b>1.2</b>	<b>1.0</b>	<b>7.8</b>	<b>5.8</b>		<b>253.4</b>

Source: Company data, Bloomberg, Concorde Capital

## Replacement cost model

We use the following assumptions in our replacement cost model.

The **value of company** is equal to the replacement value of its generation capacity in 2011, adjusted by depreciation.

**Depreciation** is calculated based on the hours worked by each power unit divided by a normative working life of 280,000 hours of operation. Figures are provided by NERC for January 1, 2011. For units in operation for more than 280,000 hours, depreciation is taken as 100%.

We additionally apply a **75% discount to gas-fired power units** as we do not see them operational in the near future.

**Replacement cost** in 2010 is assumed to be 1,500 USD/kW of capacity for coal-fired power units and 1,000 USD/kW for gas-fired power units.

$$EV = 1,500 \text{ USD} * \text{Coal-fired capacity} * (1 - \text{hours worked}/280,000) + 1,000 \text{ USD} * \text{Gas-fired capacity} * (1 - \text{hours worked}/280,000) * (1-75\%)$$

### Replacement cost calculation

	Coal-fired units				Gas-fired units			
	Installed capacity, MW	Adjusted depreciation, MW	Adjusted capacity, MW	Replacement costs, USD mln	Installed capacity, MW	Adjusted depreciation, MW	Adjusted capacity, MW	Replacement costs, USD mln
Dniproenergo	5,785	87%	776	1,163	2,400	49%	1,230	308
Zakhidenergo	4,400	88%	549	824	-	-	-	-

Source: NC ECU, Energobusiness, Company data, Concorde Capital calculations

### Replacement cost valuation, USD mln

	Coal-fired units replacement cost	Gas-fired units replacement cost	Implied EV	Implied MCap	# shares, mln	Implied price per share, USD
Dniproenergo	1,163	308	1,471	1,367	6.0	229.1
Zakhidenergo	824	-	824	751	12.8	58.7

Source: Company data, Concorde Capital calculations

### Sensitivity tables

#### Dniproenergo, USD per share

Replacement cost of coal capacity, \$ per kW	Normative working life, ths hours				
	260	270	280	290	300
1,300	136	194	196	264	259
1,400	147	208	213	283	280
1,500	229	194	229	264	301
1,600	171	208	245	283	322
1,700	183	222	262	301	344

#### Zakhidenergo, USD per share

Replacement cost of coal capacity, \$ per kW	Normative working life, ths hours				
	260	270	280	290	300
1,300	29.4	39.0	50.1	62.2	74.0
1,400	32.2	42.5	54.4	67.4	80.1
1,500	34.9	45.9	58.7	72.6	86.2
1,600	37.6	49.4	63.0	77.9	92.3
1,700	40.3	52.8	67.3	83.1	98.5

# Dniproenergo

**BUY**

Bloomberg: DNEN UK | Reuters: DNEN.PFT

12M target (USD)

156

<http://dniproenergo.ua>

Upside

58%

## INVESTMENT CASE

### Largest GenCo by capacity

Operates three power units with a total of 8.2 GW (5.8 GW gas-fired) capacity located in Dnipropetrovsk and Zaporizhya regions: Zaporizhya TPP (installed capacity 3.6 GW, 2.4 GW is gas-fired); Prydniprovsk TPP (1.74 GW) and Kryviy Rih TPP (2.82 GW). One of two GenCos that have gas-fired power units (21% of total capacity, currently idle due to high gas price).

### Most efficient in fuel consumption

The most efficient GenCo in Ukraine in terms of quantity of fuel used per kWh production (382 g vs. 399-425 for other) and own needs of electricity (7.3% vs. 7.9%-9.9% for other)

### Only GenCo to post double digit EBITDA margin

Thanks to having the lowest fuel consumption in the sector, Dniproenergo was the only GenCo to post a double-digit EBITDA margin in 2010 (10%). We expect the company to remain the most profitable in the sector in the long-term. We project the company to post USD 1,149 mln in revenue in 2011E (up 46% y-o-y) and USD 138 mln in EBITDA (up 70% y-o-y). Over the mid-term, we see Dniproenergo as the only GenCo capable of accumulating cash in excess of CapEx requirements and starting to payout dividends (which we estimate at USD 15 per share starting in 2014E).

### Revenue to grow at a 28% CAGR in 5Y due to high load

We expect Dniproenergo's top line to grow at a 28% CAGR over 2010-15E, driven by capacity utilization growth. While being the most fuel efficient Dniproenergo's capacity utilization remains on par with the sector – we expect this to change after the company becomes private-owned.

### Lowest CapEx per unit of any GenCo

We estimate CapEx to modernize all Dniproenergo's power units at USD 882 mln, or 175 USD/kW, the lowest figure of any Ukrainian GenCo, as its power units are larger scale and thus cheaper to modernize. Dniproenergo has already secured USD 51 mln in investment surcharges in its tariff from the NERC for 2010-2016 to be used to fully reconstruct unit #3 of Kryviy Rih TPP (282 MW) and unit #9 of Prydniprovsky TPP (300 MW).

### Most illiquid GenCo

Dniproenergo stock is illiquid, with an average monthly trading volume over the last year of USD 0.4 mln (we apply a 40% discount for liquidity risk in valuation). We estimate total free float at USD 15 mln, 2.45%.

## MARKET INFORMATION

Market Price, USD	98.8
52 Wk H/L USD	171.70/88.05
Chg 3m/6m/52w	-22%/42%/12%
ADT, 12M, USD mln	0.1
<b>MCap</b> , USD mln	589.5
Free float	2.54%
FF MCap, USD mln	14.4
<b>No of shares</b> , mln	5.9

## MARKET MULTIPLES

	2010	2011E	2012F
EV/S	0.9	0.6	0.5
EV/EBITDA	8.8	5.0	2.9
EV/Capacity, USD per kW	123	120	120

## KEY FINANCIALS, USD mln

	2010	2011E	2012F
Net Revenues	784.9	1,149	1,526
EBITDA	81.2	138	244
Net Income	23.8	60.3	141.2
Net Debt	91.3	179.2	186.1

## KEY RATIOS

	2010	2011E	2012F
EBITDA Margin	10.4%	12.0%	16.0%
Net Margin	3.0%	5.3%	9.3%
ROE	9.2%	18.3%	30.0%
Net Debt to Equity	33.8%	54.3%	39.5%

## STOCK OWNERSHIP

State	50.0%
DTEK	47.5%
Other	2.5%

## Dniproenergo financial statements, IFRS

### Income statement summary, USD mln

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
<b>Net Revenues</b>	<b>758.0</b>	<b>900.7</b>	<b>539.8</b>	<b>784.9</b>	<b>1,149</b>	<b>1,526</b>	<b>1,964</b>	<b>2,269</b>	<b>2,731</b>	<b>2,938</b>
Change y-o-y	37.5%	18.8%	-40.1%	45.4%	46.4%	32.8%	28.7%	15.5%	20.4%	7.6%
Cost Of Sales	(657.6)	(845.6)	(554.8)	(730.9)	(1,002.6)	(1,271.6)	(1,580.2)	(1,827.1)	(2,201.5)	(2,368.5)
Gross Profit	100.4	55.1	24.8	81.0	146.5	254.1	383.4	441.7	529.9	569.5
Other Operating Income/Costs, net	(10)	17	5.7	13.2	5.7	6	6	6	6	6
SG&A	(11.2)	(16.1)	(11.1)	(12.9)	(14.2)	(15.7)	(16.0)	(16.3)	(16.6)	(17.0)
<b>EBITDA</b>	<b>79.6</b>	<b>55.6</b>	<b>19.4</b>	<b>81.2</b>	<b>137.9</b>	<b>244.1</b>	<b>373.1</b>	<b>431.1</b>	<b>519.0</b>	<b>558.2</b>
EBITDA margin, %	10.5%	6.2%	3.6%	10.4%	12.0%	16.0%	19.0%	19.0%	19.0%	19.0%
Depreciation	(36.7)	(36.1)	(24.8)	(26.9)	(34.3)	(41.6)	(48.9)	(56.3)	(63.6)	(70.9)
<b>EBIT</b>	<b>42.9</b>	<b>19.5</b>	<b>(5.4)</b>	<b>54.3</b>	<b>103.6</b>	<b>202.5</b>	<b>324.1</b>	<b>374.8</b>	<b>455.3</b>	<b>487.3</b>
EBIT margin, %	5.7%	2.2%	-1.0%	6.9%	9.0%	13.3%	16.5%	16.5%	16.7%	16.6%
Interest Expense	(9.2)	(10.0)	(12.9)	(14.2)	(24.0)	(23.0)	(12.0)	(4.5)	(5.5)	-
Financial income/(expense)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Other income/(expense)	(0.6)	0.5	0.5	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)
<b>PBT</b>	<b>33.1</b>	<b>10.0</b>	<b>(17.9)</b>	<b>39.3</b>	<b>78.9</b>	<b>178.8</b>	<b>311.4</b>	<b>369.5</b>	<b>449.1</b>	<b>486.5</b>
Tax	(9.0)	(9.6)	-	(15.5)	(18.5)	(37.5)	(59.2)	(59.1)	(71.9)	(77.8)
<b>Net Income</b>	<b>24.1</b>	<b>0.4</b>	<b>(17.9)</b>	<b>23.8</b>	<b>60.3</b>	<b>141.2</b>	<b>252.2</b>	<b>310.4</b>	<b>377.2</b>	<b>408.7</b>
Net Margin, %	3.2%	0.0%	-3.3%	3.0%	5.3%	9.3%	12.8%	13.7%	13.8%	13.9%

Source: Company data, Concorde Capital projections

### Balance sheet summary, USD mln

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
<b>Current Assets</b>	<b>125.3</b>	<b>150.1</b>	<b>144.5</b>	<b>198.0</b>	<b>282.8</b>	<b>375.5</b>	<b>483.3</b>	<b>658.4</b>	<b>892.6</b>	<b>1,160.1</b>
Cash & Equivalents	11.9	8.5	10.5	7.9	11.6	15.4	19.8	122.8	247.9	466.6
Trade Receivables	21.3	27.6	42.8	56.8	83.2	110.5	142.2	164.2	197.7	212.7
Inventories	69.7	85.0	61.0	84.7	124.0	164.6	211.9	244.8	294.7	317.0
Other current assets	22.3	29.0	30.2	48.6	64.0	85.0	109.4	126.5	152.2	163.8
<b>Fixed Assets</b>	<b>365.1</b>	<b>292.2</b>	<b>280.0</b>	<b>325.7</b>	<b>420.6</b>	<b>508.6</b>	<b>596.6</b>	<b>684.6</b>	<b>772.6</b>	<b>860.6</b>
PP&E, net	319.3	249.7	231.5	227.3	315.3	403.3	491.3	579.3	667.3	755.3
Other Fixed Assets	45.8	42.5	48.5	98.4	105.3	105.3	105.3	105.3	105.3	105.3
<b>Total Assets</b>	<b>490.3</b>	<b>442.3</b>	<b>424.5</b>	<b>523.7</b>	<b>703.4</b>	<b>884.1</b>	<b>1,079.9</b>	<b>1,343.0</b>	<b>1,665.2</b>	<b>2,020.8</b>
<b>Shareholders' Equity</b>	<b>336.1</b>	<b>269.2</b>	<b>233.1</b>	<b>269.7</b>	<b>330.0</b>	<b>471.2</b>	<b>723.5</b>	<b>1,033.9</b>	<b>1,411.1</b>	<b>1,819.8</b>
Share Capital	227.7	149.4	18.7	18.7	18.7	18.7	18.7	18.7	18.7	18.7
Reserves and Other	453.1	337.0	466.6	482.5	482.5	482.5	482.5	482.5	482.5	482.5
Retained Earnings	(344.7)	(217.1)	(252.2)	(231.5)	(171.2)	(30.0)	222.2	532.7	909.9	1,318.6
<b>Current Liabilities</b>	<b>153.5</b>	<b>169.7</b>	<b>178.3</b>	<b>244.3</b>	<b>363.6</b>	<b>403.1</b>	<b>356.4</b>	<b>309.1</b>	<b>254.1</b>	<b>201.0</b>
ST Interest Bearing Debt	38.7	64.9	58.9	89.4	181.0	191.7	111.6	40.3	-50.3	-120.8
Trade Payables	31.0	36.9	45.3	56.4	82.6	109.7	141.2	163.1	196.4	211.3
Accrued Wages	2.3	2.1	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Accrued Taxes	11.8	10.9	9.9	15.6	17.2	18.9	20.8	22.9	25.2	27.7
Other Current Liabilities	69.8	54.9	62.1	80.6	80.6	80.6	80.6	80.6	80.6	80.6
<b>LT Liabilities</b>	<b>0.7</b>	<b>0.5</b>	<b>13.1</b>	<b>9.8</b>	<b>9.8</b>	<b>9.8</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
LT Interest Bearing Debt	-	-	13.1	9.8	9.8	9.8	0.0	0.0	0.0	0.0
Other LT	0.7	0.5	-	-	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Liabilities &amp; Equity</b>	<b>490.3</b>	<b>439.4</b>	<b>424.5</b>	<b>523.7</b>	<b>703.4</b>	<b>884.1</b>	<b>1,079.9</b>	<b>1,343.0</b>	<b>1,665.2</b>	<b>2,020.8</b>
<b>Net Debt</b>	<b>26.8</b>	<b>56.4</b>	<b>61.5</b>	<b>91.3</b>	<b>179.2</b>	<b>186.1</b>	<b>91.8</b>	<b>(82.6)</b>	<b>(298.2)</b>	<b>(587.4)</b>

Source: Company data, Concorde Capital projections

### UAH/USD exchange rates

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Average	5.05	6.22	7.800	7.94	8.00	8.00	8.00	8.00	8.00	8.00
Year-end	5.05	7.70	7.985	7.96	8.00	8.00	8.00	8.00	8.00	8.00

Source: National Bank of Ukraine, Concorde Capital projections



## Zakhidenergo

**HOLD**

Bloomberg: ZAEN UK | Reuters: ZAEN.PFT

12M target (USD)

47

<http://www.zakhidenergo.ua/>

Upside

20%

### INVESTMENT CASE

#### 4.4 GW coal-fired capacity, Ukraine's exclusive exporter

Operates 3 coal-fired power units with a total capacity of 4.4 GW located in Western Ukraine: Burstyn TPP (installed capacity 2.3 GW); Dobrotvir TPP (0.6 GW) and Ladyzhyn TPP (1.8 GW). Burstyn TPP is separated from Ukraine's energy system and works in the Burstyn Energy Island – which works in parallel with the European network, with monopoly access to export markets in Hungary, Romania and Slovakia. Export capacity is 500-550 MW from Burstyn TPP. Dobrotvir TPP is located near the Polish border and can work for the Polish energy system.

#### Barely breaking even on EBITDA

With Zakhidenergo's EBITDA margins within 3% of zero the last three years, it has barely broken even on EBITDA and posted net losses. We see several factors behind that beyond regulatory challenges: a shortage of gas coal (a key fuel) raised fuel costs, high transportation costs due its distance to coal mines and relatively low fuel efficiency. While we see its margin improving in the mid-term to 12% in 2015E (when gas coal supplies rebound), we expect the company's earnings to only cover its needs for modernization CapEx.

#### Revenue to increase at 21% CAGR in 5Y

We project Zakhidenergo's revenue to grow at a 21% CAGR in 2010-15, thanks to a low base in 2010, electricity price growth capacity utilization increase. In 2011, we expect the company to post USD 832 mln in revenues (up 32% y-o-y) and USD 33.3 mln in EBITDA (up 3x y-o-y).

#### Electricity export sales do not earn extra profit

Even though Zakhidenergo is the only GenCo connected to the EU electricity grid, it is not able to profit from electricity exports even if EU prices are above Zakhidenergo's. Under current regulations, all electricity is exported by a trader (currently DTEK), while Zakhidenergo sells export-directed electricity at the same prices as domestic.

#### Highest CapEx requirements to replenish assets

We estimate Zakhidenergo needs USD 1,071 mln over the next 10 years to modernize its power units, the highest figure among all GenCos (USD 254 per kW, second highest after Donbasenergo).

#### Low liquidity in UX index stock

Even though Zakhidenergo remains a component of both the UX and PFTS indices, liquidity has decreased significantly since DTEK bought most of the free float in 2010 (increasing its stake from 12% to 25%). Average monthly trading volume over the last year was USD 2.2 mln (we apply a 20% discount for liquidity risk in valuation).

### MARKET INFORMATION

Market Price, USD	39.42
52 Wk H/L USD	71.57/37.36
Chg 3m/6m/52w	-11%/-29%/4%
Avg M Tr Vol 6M, USD mln	1.4
<b>MCap</b> , USD mln	503,6
Free float	4.0%
FF Mcap, USD mln	20.1
<b>No of shares</b> , mln	12.8
Par Value, UAH	

### MARKET MULTIPLES

	2010	2011E	2012E
EV/S	0.9	0.7	0.5
EV/EBITDA	52.6	17.3	7.7
EV/Capacity, USD per kW	132	131	131

### KEY FINANCIALS, USD mln

	2010	2011E	2012E
Net Revenues	630.4	832.2	1,075.5
EBITDA	11	33	75
Net Income	-23.5	6.5	23.4
Net Debt	49.3	74.7	178.9

### KEY RATIOS

	2010	2011E	2012E
EBITDA Margin	1.7%	4.0%	7.0%
Net Margin	-3.7%	0.8%	2.2%
ROE	-24%	9%	25%
Net Debt to Equity	0.8	1.1	1.9

### STOCK OWNERSHIP

State (NC ECU)	70.1%
DTEK	24.9%
Other	5%

## Zakhidenergo financial statements, IFRS

### Income statement summary, USD mln

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
<b>Net Revenues</b>	<b>715.8</b>	<b>923.4</b>	<b>573.9</b>	<b>630.4</b>	<b>832.2</b>	<b>1,075.5</b>	<b>1,322.7</b>	<b>1,470.6</b>	<b>1,647.8</b>	<b>1,764.2</b>
Change y-o-y	16.0%	29.0%	-37.8%	9.8%	32.0%	29.2%	23.0%	11.2%	12.1%	7.1%
Cost Of Sales	(642.2)	(864.1)	(593.3)	(598.5)	(776.5)	(976.3)	(1,192.6)	(1,284.2)	(1,425.1)	(1,509.5)
Gross Profit	73.5	59.2	12.3	44.5	55.6	99.2	130.1	186.4	222.7	254.7
Other Operating Income/Costs, net	(13)	(15)	(6.4)	(19.0)	(6.4)	(6)	(6)	(6)	(6)	(6)
SG&A	(14.9)	(17.8)	(12.8)	(14.4)	(15.9)	(17.5)	(17.8)	(18.2)	(18.6)	(18.9)
<b>EBITDA</b>	<b>45.9</b>	<b>26.1</b>	<b>(7.0)</b>	<b>11.0</b>	<b>33.3</b>	<b>75.3</b>	<b>105.8</b>	<b>161.8</b>	<b>197.7</b>	<b>229.3</b>
EBITDA margin, %	6.4%	2.8%	-1.2%	1.7%	4.0%	7.0%	8.0%	11.0%	12.0%	13.0%
Depreciation	(10.9)	(14.1)	(12.3)	(12.6)	(12.6)	(21.5)	(30.4)	(39.3)	(48.3)	(57.2)
<b>EBIT</b>	<b>35.0</b>	<b>12.0</b>	<b>(19.3)</b>	<b>(1.6)</b>	<b>20.7</b>	<b>53.8</b>	<b>75.4</b>	<b>122.4</b>	<b>149.5</b>	<b>172.2</b>
EBIT margin, %	4.9%	1.3%	-3.4%	-0.3%	2.5%	5.0%	5.7%	8.3%	9.1%	9.8%
Interest Expense	(16.1)	(17.6)	(14.9)	(13.1)	(12.0)	(24.0)	(32.0)	(36.0)	(39.0)	(40.0)
Financial income/(expense)	(0.0)	0.0	-	-	-	-	-	-	-	-
Other income/(expense)	0.8	(4.2)	0.5	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
<b>PBT</b>	<b>19.7</b>	<b>(9.7)</b>	<b>(33.6)</b>	<b>(14.9)</b>	<b>8.5</b>	<b>29.6</b>	<b>43.2</b>	<b>86.2</b>	<b>110.3</b>	<b>132.0</b>
Tax	(9.9)	(6.0)	-	(8.6)	(2.0)	(6.2)	(8.2)	(13.8)	(17.6)	(21.1)
<b>Net Income</b>	<b>9.9</b>	<b>(15.7)</b>	<b>(33.6)</b>	<b>(23.5)</b>	<b>6.5</b>	<b>23.4</b>	<b>35.0</b>	<b>72.4</b>	<b>92.6</b>	<b>110.9</b>
Net Margin, %	1.4%	-1.7%	-5.9%	-3.7%	0.8%	2.2%	2.6%	4.9%	5.6%	6.3%

Source: Company data, Concorde Capital projections

### Balance sheet summary, USD mln

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
<b>Current Assets</b>	<b>195.8</b>	<b>172.1</b>	<b>132.7</b>	<b>150.9</b>	<b>199.2</b>	<b>257.4</b>	<b>316.6</b>	<b>351.9</b>	<b>394.4</b>	<b>422.2</b>
Cash & Equivalents	0.2	0.5	4.9	5.7	7.6	9.8	12.0	13.4	15.0	16.1
Trade Receivables	114.7	82.3	48.6	38.2	50.4	65.1	80.1	89.1	99.8	106.9
Inventories	46.3	56.0	44.5	50.5	66.6	86.1	105.9	117.8	132.0	141.3
Other current assets	34.6	33.3	34.7	56.5	74.5	96.3	118.5	131.7	147.6	158.0
<b>Fixed Assets</b>	<b>335.0</b>	<b>240.2</b>	<b>242.8</b>	<b>247.0</b>	<b>262.0</b>	<b>369.0</b>	<b>476.0</b>	<b>583.0</b>	<b>690.0</b>	<b>797.0</b>
PP&E, net	272.7	180.4	176.2	180.2	195.2	302.2	409.2	516.2	623.2	730.2
Other Fixed Assets	62.3	59.9	66.6	66.8	66.8	66.8	66.8	66.8	66.8	66.8
<b>Total Assets</b>	<b>530.8</b>	<b>412.3</b>	<b>375.5</b>	<b>397.8</b>	<b>461.1</b>	<b>626.4</b>	<b>792.5</b>	<b>934.9</b>	<b>1084.3</b>	<b>1219.2</b>
<b>Shareholders' Equity</b>	<b>284.2</b>	<b>170.7</b>	<b>115.8</b>	<b>63.7</b>	<b>70.2</b>	<b>93.6</b>	<b>128.6</b>	<b>201.0</b>	<b>293.6</b>	<b>404.5</b>
Share Capital	25.3	16.6	16.0	16.1	16.1	16.1	16.1	16.1	16.1	16.1
Reserves and Other	323.2	219.6	210.9	184.5	184.5	184.5	184.5	184.5	184.5	184.5
Retained Earnings	(64.3)	(65.5)	(111.1)	(136.9)	(130.4)	(107.0)	(72.0)	0.4	93.0	203.9
<b>Current Liabilities</b>	<b>207.7</b>	<b>222.7</b>	<b>237.0</b>	<b>310.0</b>	<b>366.8</b>	<b>411.1</b>	<b>442.3</b>	<b>512.3</b>	<b>569.0</b>	<b>593.0</b>
ST Interest Bearing Debt	123.3	81.4	74.6	52.6	79.8	88.7	83.6	130.6	160.1	164.8
Trade Payables	42.4	32.1	80.2	85.7	113.1	146.2	179.8	199.9	224.0	239.9
Accrued Wages	2.7	2.1	1.6	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Accrued Taxes	4.1	21.1	4.3	21.6	23.8	26.2	28.8	31.7	34.9	38.3
Other Current Liabilities	35.2	86.1	76.3	147.7	147.7	147.7	147.7	147.7	147.7	147.7
<b>LT Liabilities</b>	<b>38.9</b>	<b>18.5</b>	<b>22.7</b>	<b>24.1</b>	<b>24.1</b>	<b>121.7</b>	<b>221.7</b>	<b>221.7</b>	<b>221.7</b>	<b>221.7</b>
LT Interest Bearing Debt	7.4	4.9	10.6	2.4	2.4	100.0	200.0	200.0	200.0	200.0
Other LT	31.5	13.6	12.2	21.7	21.7	21.7	21.7	21.7	21.7	21.7
<b>Total Liabilities &amp; Equity</b>	<b>530.8</b>	<b>411.9</b>	<b>375.5</b>	<b>397.8</b>	<b>461.1</b>	<b>626.4</b>	<b>792.5</b>	<b>934.9</b>	<b>1084.3</b>	<b>1219.2</b>
<b>Net Debt</b>	<b>130.5</b>	<b>85.9</b>	<b>80.2</b>	<b>49.3</b>	<b>74.7</b>	<b>178.9</b>	<b>271.6</b>	<b>317.2</b>	<b>345.1</b>	<b>348.7</b>

Source: Company data, Concorde Capital projections

### UAH/USD exchange rates

	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Average	5.05	6.22	7.800	7.94	8.00	8.00	8.00	8.00	8.00	8.00
Year-end	5.05	7.70	7.985	7.96	8.00	8.00	8.00	8.00	8.00	8.00

Source: National Bank of Ukraine, Concorde Capital projections

## Appendices

### Analyst certification

We, Yegor Samusenko and Antonina Davydenko, 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.

### GenCos rating history

Date	DNEN price, USD		ZAEN price, USD	
	Closing	Target	Closing	Target
13-May-05	75	88	27.7	29
30-May-05			27.7	30.5
4-Jul-05				
19-Jul-05			24	30.5
26-Sep-05	67	99	26	34
3-Jan-06				
26-Jun-06	76	123	26.5	34
25-Sep-06			32	34
26-Sep-06				
15-Nov-06	109	131	40	35.4
28-Nov-06	109	131	41	35.4
22-Dec-06	126	134	52.8	41.2
21-Mar-07	288	383	73.4	94.3
2-Apr-07	347	383	88.1	94.3
22-Jun-07	400	432		
23-Jul-07	366	432		
31-Aug-07	373	410		
10-Sep-07	383	410	103.8	94.3
10-Oct-07	512	516	121.7	130.4
24-Mar-08	424	516		
10-Apr-08	430	516		
28-May-08	417	580	89.1	125
27-Jun-08	385	460		
24-Nov-08	69	260	51.5	88
26-Nov-08	70	266	53.0	88
03-Feb-09	62	284	45.7	96.6
24-Mar-09	53	284		
08-Apr-10	183	326	56.9	86.7
19-Aug-10	133	200		
06-Sep-10	136	200	66.8	74.3
05-Nov-10	130	200	66.8	66.9
13-Dec-10	151	200	59.0	68.8
28-Jul-11	102	156	39.6	47

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