



CONCORDE CAPITAL

# Ukraine/ Metallurgy DniproSpetsStal

Thawing Out

## BUY

16 Feb 2006

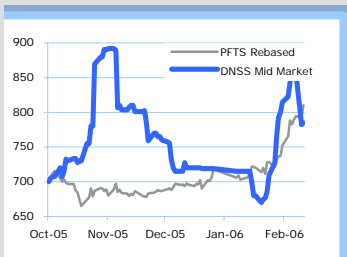
USD 168.0

12m Target

USD 201.6

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### DNSS, UAH



### Market Information

No of Shares, mln	1.08
Market price, USD	168.0
MCap, USD mln	180.6
Free Float, %	4.5%
FF MCAP, USD mln	8.1

### Stock Ownership, %

Interpipe/Grigorishin	59.97
Kyiv group	34.19
Minority Shareholders	5.85

### Ratios 2005E

EBITDA Margin	6.7%
Net Margin	2.4%
Net Debt/Equity	0.56

DniproSpetsStal has secured its niche as a specialty steel producer occupying a monopolistic position in the domestic market and establishing a strong presence abroad. With the end of corporate wars and phasing out of transfer pricing on the horizon, the company should really come out of the shadows in 2007. We initiate our coverage of the stock with a BUY recommendation and a 12 month target of USD 201.6 per share based on DCF valuation. This suggests an upside of 20%.

**Technology Complicacy Limits Competition.** DniproSpetsStal's specialized equipment and technological expertise are an effective barrier to entry into the company's market segment by potential competitors both in Ukraine and abroad. It is currently one of the two plants in Ukraine which operates electric arc furnaces (EAF) for steel smelting.

**Gas Not An Issue.** The EAF steel smelting process employed by DniproSpetsStal does not require natural gas and thus, puts the company at advantage to those Ukrainian steel makers which use the open hearth furnace (OHF) method if Russia raises its gas prices significantly.

**Less Dependent On Exports.** DniproSpetsStal sells ~40% of its output domestically, twice as much on average, as other Ukrainian steel mills. It caters to the Ukrainian machine building, engineering, pipe-making and construction industries. As a result, the company's sales are less exposed to external shocks and less volatile.

**Market Outlook Positive.** Worldwide demand for specialty steel is expected to grow driven by the development of mechanical engineering, electrical machinery and construction. In particular, stainless steel production (5.8% CAGR in 1980-2004) is forecast to continue its upward trend with a 4.7% growth in 2006. Although the threat of China becoming a net exporter of stainless steel exists, at present Chinese stainless steel is not quality competitive.

**Related Party Transactions On The Way Out.** We have observed signs that suggest the company is cutting back on its shady business practices. In our view, this has to do with the effect of Tymoshenko's government whose actions in 1H05 pushed Ukrainian business groups toward greater transparency as well as by the general evolution of business in the country. We expect DniproSpetsStal's related party transactions and unresolved ownership disputes to be settled in 2007.

### KEY FINANCIAL DATA, USD mln

	Net Revenue	EBITDA	Net Income	DPS, USD
2004	305.0	31.7	16.9	0.000
2005E	467.4	31.4	11.2	0.000
2006E	492.3	49.2	25.7	7.158

Spot Exchange Rate 5.05

### KEY RATIOS

	EV/S	EV/EBITDA	P/E	Div Yield
2004	0.74	7.14	10.68	0.0%
2005E	0.53	7.83	16.10	0.0%
2006E	0.47	4.73	7.04	4.3%

## Monopoly Producer Of Specialty Steels

### Specialty As Opposed To Commodity

DniproSpetsStal focuses on making alloyed steels with specific properties that ordinary steels do not possess in order to meet special requirements from a number of industries. This puts the mill in a separate market segment, where it does not face competition from ordinary steel makers. Thanks to this, DniproSpetsStal enjoys a monopoly status on the domestic market and has secured a niche abroad.

The company's product assortment encompasses over 800 grades of steel and over 1,000 profiles of rolled products. The mill is able to take highly customized and complicated client orders. The distinct features of the company's steels are high alloying element content and complex processing. DniproSpetsStal's key products are described in the Appendix.

### Advanced Technology: DNSS's Key Competitive Advantage

DniproSpetsStal uses an electric arc furnace process (EAF) to produce high quality electrical steel, which is then rolled into different types of long steel products. **The technology does not require natural gas.** The company is conveniently located in close proximity to DniproGES, a Zaporizhzhya-based hydro-generating power plant, which ensures an uninterrupted supply of electricity.

DniproSpetsStal is one of the two steel makers in Ukraine who use EAF process. In 2004, DniproSpetsStal accounted for nearly 40% of all electrical steel produced in Ukraine.

#### Crude Steel output By Process

	Oxygen	Electric	Open hearth
<b>Ukraine</b>	<b>49.8%</b>	<b>6.8%</b>	<b>43.4%</b>
Russia	61.6%	16.3%	22.1%
EU (25)	61.4%	38.6%	0.0%

Source: IISI

The key input in EAF technology is metal scrap, which contributes to the purity and quality of the steel produced. European smelters of quality steel for the most part use EAF.

The complexity of DniproSpetsStal's technology goes far beyond merely using EAF. After crude steel is melted in EAF, ingots (a semi-finished product) go through re-melting in either electroslag or vacuum-arc processes, which reduces the impurity content and impart desired value adding properties in the finished steel product. The company also has an induction-arc furnace to make heat resistant and precision alloys.

In addition to EAF, DniproSpetsStal operates a powder metallurgy workshop commissioned in 1980, which produces high quality tool and high-speed steels.

### The Competition: Thinner Than For Ordinary Steel

DniproSpetsStal faces no domestic competition, and few of its competitors from CIS countries have the sophisticated technology and production expertise required to match the steel produced by DNSS. In the former Soviet Union, only a few Russian companies can produce specialty steels that are somewhat comparable to those made by DniproSpetsStal.

The Main Russian Specialty Steel Makers:

**Mechel**  
**Electrostal**  
**Zlatoustovski Metal**  
**Serov Metal Plant**  
**Spetstal**  
**Izhstal**  
**Sibelectrostal**

Russian producers focus mainly on flat steel products, whereas DniproSpetsStal produces sections, and therefore, their markets only slightly overlap.

Apart from CIS steel makers, in international markets DniproSpetsStal competes with steel majors who have specialty/ stainless steel divisions, such as

**Nippon**  
**Arcelor**  
**ThyssenKrupp**  
**Outokumpu**  
**Posco**  
**Taiyuan Iron & Steel**  
**Baosteel**  
**Shagang Group**

and purely stainless steel smelters such as **Acerinox S. A.**

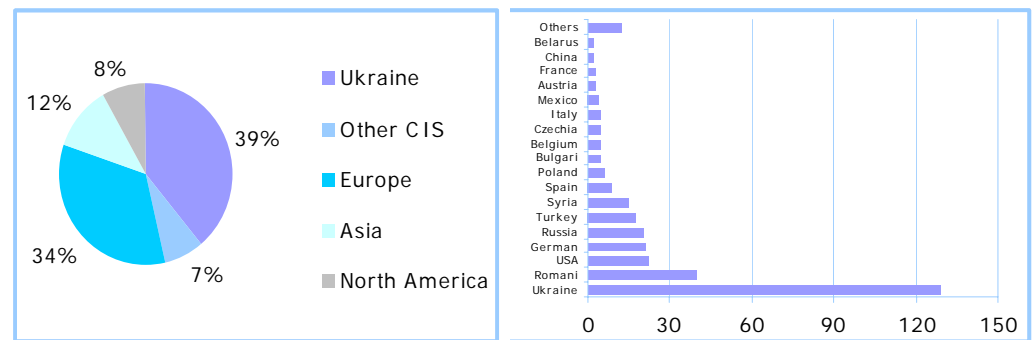
With an estimated crude steel production capacity of ~1.4 mln mt per year, DniproSpetsStal operated at 36% capacity in 2005. Significant underutilization allows the company to easily adjust its output to follow demand fluctuations.

## Stable Domestic High-End European Markets

While overall, Ukraine consumes only ~20% of the steel it produces, DniproSpetsStal relies on the domestic market more than most of Ukraine's other steel makers. The company sells 39% of its output locally. The role of the local market as a safety net reduces the company's business risk.

The company's exports are well diversified and focus on the high-end European market. While Ukraine's other steel makers were severely restricted from exporting rolled steel to Europe by quotas imposed by the EU, Europe accounts for 34% of all DniproSpetsStal's shipments.

**Dniprospetsstal's Sales Breakdown By Region, ths mt**



Source: Company data; ISSF

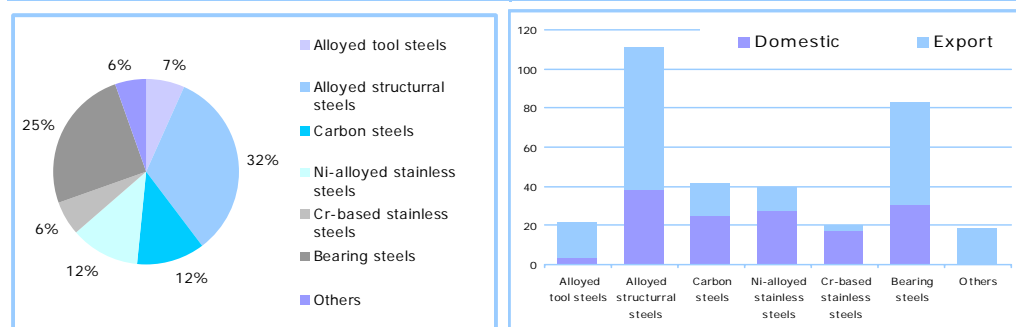
## Market Bodes Well

### Specialty Steels

Due to the character of DniproSpetsStal's products, their respective demand-supply dynamics, with the exception of the stainless steel segment, is hard to track.

In terms of its products, alloyed structural and bearing steels made up 57% of DniproSpetsStal's tonnage sales in 2004 and also comprised ~65% of its exports. The industries that consumed most of DniproSpetsStal's products were machine building and construction. Among domestic consumers, stainless pipe makers were part of this group.

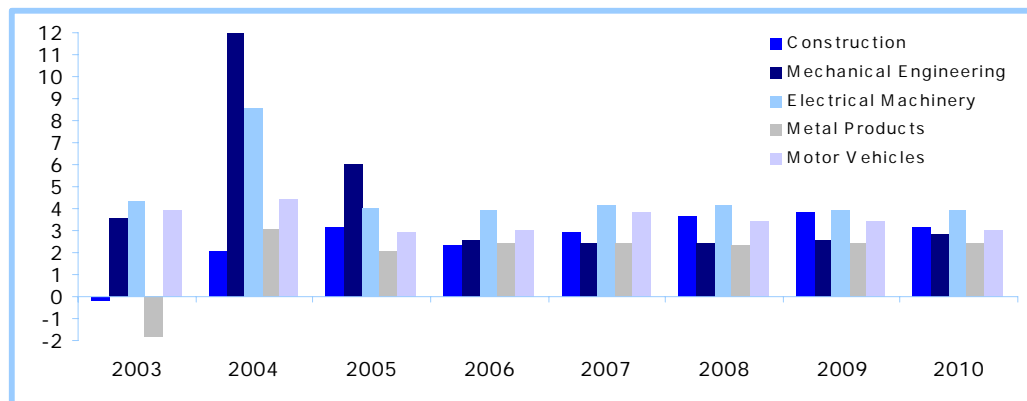
### Dniprospetsstal's Sales Breakdown By Product, ths mt



Source: Company data; ISSF

Forecasts of production dynamics for the industries that consume specialty steel give us grounds to expect robust future demand.

### Industry Growth: Change Vs. Previous Year, %

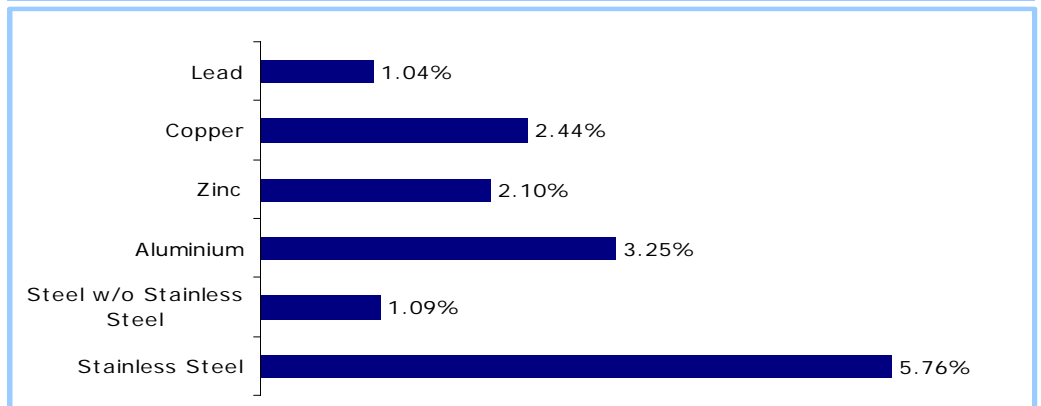


Source: OEF

### Stainless Steels

Global stainless steel production was the most dynamic segment of metallurgy with a CAGR of 5.76% in 1980-2004 as opposed to just 1.09% for all other steels combined.

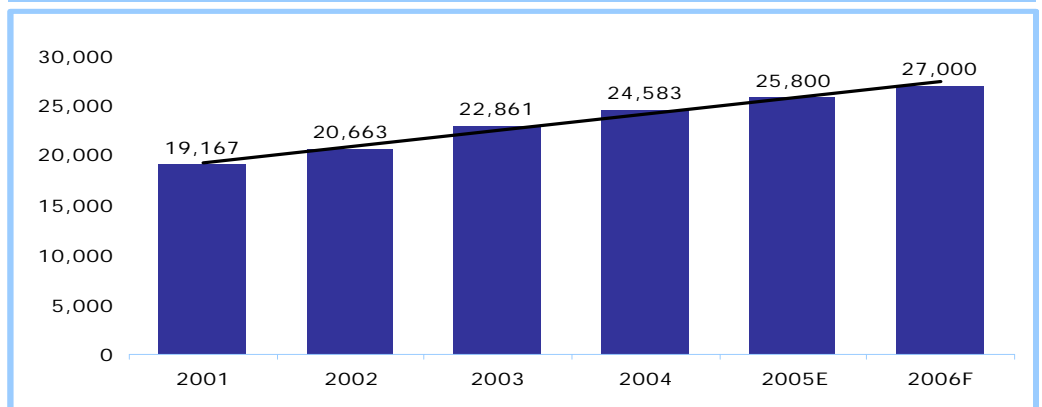
### Stainless Steel Production CAGR 1980-2004



Source: ISSF

Stainless steel output growth has been showing a distinct upward trend and the outlook remains positive:

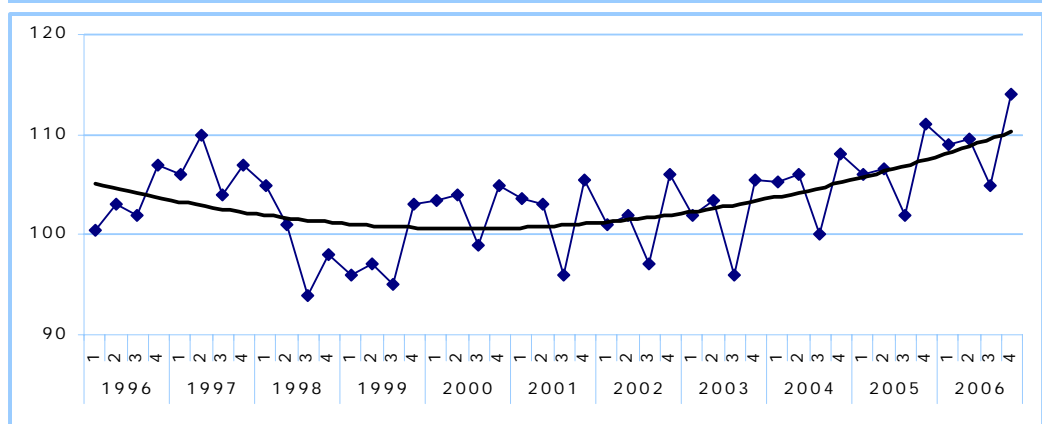
### Global Stainless Steel Production Dynamics



Source: ISSF

This is due to a growing demand for alloyed steels:

### Global Stainless Steel Demand Index, Long Products



Source: ISSF; OEF

### The Asian Invasion: Less Troubling Than For Ordinary Steels

Region-wise, Asia headed by China was both a major producer and a major consumer of stainless steel. In 1H05, China produced 1.69 mln of stainless steel (up 54% yoy) and its apparent consumption totaled 2.95 mln mt, not including specialty heat-resistant steels. Chinese stainless steel makers are expected to increase their production capacities in 2006 by more than 70% to exceed 9 mln mt annually.

Stainless And Heat Resistant Crude Steel Production By Region, ths mt								
Region	2003	% of total	2004	% of total	+/- in 2004, %	2005E	% of total	+/- in 2005E, %
Western Europe/Africa	9,043	39.6%	9,414	38.3%	4.1%	9,650	37.4%	2.5%
Central and Eastern Europe	341	1.5%	343	1.4%	0.6%	350	1.4%	2.0%
The Americas	2,830	12.4%	2,929	11.9%	3.5%	3,000	11.6%	2.4%
Asia	10,645	46.6%	11,896	48.4%	11.8%	12,800	49.6%	7.6%
<b>Total World</b>	<b>22,861</b>		<b>24,583</b>		<b>7.5%</b>	<b>25,800</b>		<b>5.0%</b>

Source: ISSF

The stainless steel market is lagging approximately two years behind the market for regular steel grades.

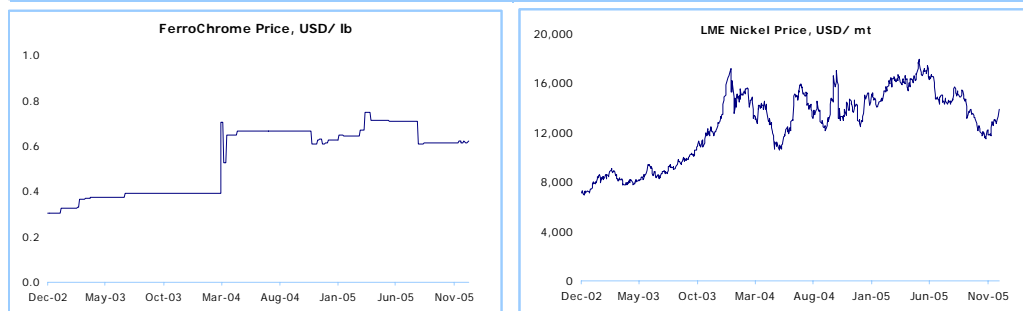
Although there is a perceived distant risk that a build-up of capacities in China may result in the country turning from a net import to a net exporter of stainless steel and thus flood global markets, we think that DniproSpetStal's risk exposure is small. This is because Asian markets are not critical for the company. In addition, a **narrow product range and the inferior quality of Chinese stainless steel presently hamper its export**. However, the Chinese government will likely restrain the country's stainless steel output, just like it is planning to do with ordinary steel production.

## Non-Ferrous Metal Prices A Cost Determinant

### Market For Alloying Elements

The specialty steels DniproSpetsStal produces require numerous alloying elements for their production to impart their superior properties. Two of the most widely used elements are Nickel (Ni) and Chromium (Cr). The latter is commonly used in a compound with iron, or ferrochrome. Prices for Nickel and Chromium have been growing for the past three years and only recently started to stabilize.

#### Ni And Ferrochrome Price Dynamics

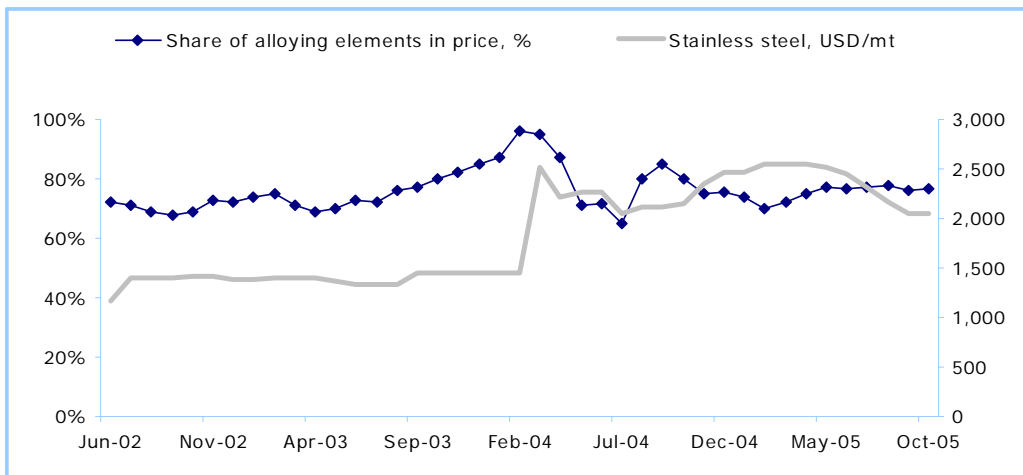


Source: Bloomberg; LME

Alloying elements are the key drivers of production costs for highly alloyed steel grades.

We do not expect significant price hikes for Nickel and ferrochrome similar to those in 1H05, to occur in the mid-term future. Thus, production costs for alloyed steel makers, including DniproSpetsStal, are not likely to grow sharply in the meantime.

#### Share Of Alloying Elements In Stainless Steel Price



Source: Metalltorg; Bloomberg

### Slag-Heaps Recycling Option

In addition to buying alloyed elements and steel scrap for the market, DniproSpetsStal could potentially save money by taking advantage of a low cost feedstock – the company can utilize scrap mined from the Balka Serednya dump in Zaporizhzhya oblast. DniproSpetsStal, Zaporizhzhya Ferroalloy and Zaporizhstal have been storing their waste in Balka Serednya since 1937. DniproSpetsStal owns two plots there, DSS-1 and DSS-2, with a total area of 46 hectares.

During the Soviet period, tons of a valuable scrap that could have been recycled was dumped there along with other waste. In addition to iron, the dump contains many different alloying elements, such as Ni and Cr, which allows the company to save on purchases of these expensive inputs by an estimated 5-6%.



However, DniproSpetsStal has not utilized its slag-heaps intensively, in fact, a number of shady companies associated with its minority shareholder have exploited its plots. Over a period of several years these companies already quarried and sold most the materials with the highest market value and the lowest extraction cost. Therefore, we believe that at present DniproSpetsStal's dump-heaps do not represent a substantial value addition for the company. In our view, even if DniproSpetsStal regains control over the extraction operations at its dumps, its production costs will not be reduced substantially.

## Conflicts Impair Corporate Governance

Due to a conflict between DniproSpetsStal's two major shareholders, Konstantin Grigorishyn's group and Grigory Surkis/ Viktor Medvedchuk (the Kyiv group), the company's manufacturing potential was not realized in full. By 2005, DniproSpetsStal's shareholder structure changed with a new player, Interpipe, showing up on the scene.

### Conflict History

Grigorishyn, a Russian businessman, accumulated a controlling stake in DniproSpetsStal in 1998. An estimated 60% of the company's shares were entitled to a number of offshore entities related to Grigorishyn. The Kyiv group was allegedly Grigorishyn's junior partner and owned a 34% stake in DniproSpetsStal. Grigorishyn's group exercised operating control over the company, while the Kyiv group was involved in the business of selling precious raw materials mined from DniproSpetsStal's dump heaps.

In 2001, a conflict with political implications broke out between the two key shareholders. Grigorishyn's business in Ukraine fell on hard times, and he had to sell his stake in DniproSpetsStal to an alliance of Baring Vostok Capital Partners and its Russian partner Veda. It appeared though that the alliance did not intend to run the company but rather acted in the interest of Interpipe, a large business group headed by Viktor Pinchuk, the son-in-law of then-President Leonid Kuchma. Interpipe managed to protect its business interests from the Kyiv group, and 2004 saw significant improvement in the company's performance. In March 2005, DniproSpetsStal's AGM appointed new management loyal to Interpipe.

On April 28, 2005, DniproSpetsStal signed a two-month contract for the extraction of alloyed scrap from its dumps with Regionpromservis, a company allegedly associated with the Kyiv group. Rumor had it that this was how Interpipe and the Kyiv group resolved the conflict surrounding DniproSpetsStal.

However, in June 2005 DniproSpetsStal started to put pressure on the companies exploiting its slag-heaps. Word was that Grigorishyn decided to reclaim his ownership rights in DniproSpetsStal and also oust the Kyiv group from the company's scrap dumps. He was able to do so because his opponents lost their political influence when the new government came to power in early 2005. On October 20, 2005 DniproSpetsStal's CEO Mr. Shyrokov who was appointed by Interpipe was replaced by Mr. Cherniavskiy an ally of Grigorishyn.

It is not clear how Grigorishyn's confrontation with Interpipe will end. In our view, the most likely scenario would be Grigorishyn taking over operating control of the company, either with or without direct ownership, as Interpipe is not in favor with the new government. We think that most major property rights disputes will be resolved within a one year timeframe. After that, we believe, the company's business will not be hurt by stakeholder infightings.

Meanwhile, the likely implications of the transition period for the company are:

- low transparency
- lower operating efficiency
- reduction of transfer pricing due to the ousting of Interpipe

We expect major improvements in both DniproSpetsStal's operations and corporate governance to start happening in 2007.

## Related Party Transactions On The Way Out

We have found that DniproSpetsStal does engage in transfer pricing schemes through related companies, although this is decreasing. In our view, Interpipe's control over the company prior to 2005 was conducive to related party transactions. In 2004, approximately 14% of DniproSpetsStal's steel output was exported via Nyzhnyodniprovsky Pipe Rolling (NPR), BIPE Co., a number of sugar plants and other companies controlled by Interpipe. The main incentive for doing so was to receive VAT refunds on exports from the government.

On the contrary, we estimate that in 9M05 only about 7% of DniproSpetsStal's output was sold abroad via Interpipe-related entities, mostly NPR. The new government's crackdown on VAT refund schemes and across-the-board inspections by tax authorities of certain business groups must have led to this.

	2004	9M05
<b>Trading through related companies</b>	14%	7%
<b>Average price undercutting</b>	-16%	-5%

*Source: Concorde Capital, Ukrainian Customs Service*

In addition, we estimate that the price for DniproSpetsStal's steel implied by its sales was lower than the market. Yet, price undercutting apparently fell from ~16% in 2004 to 5% in 9M05.

All in all, we observe a decline in shady transactions practiced by DniproSpetsStal and expect their full phase-out in 2007 due to both pressures by the government and improved corporate governance standards regardless of who will be DniproSpetsStal's controlling shareholder.

## Valuation

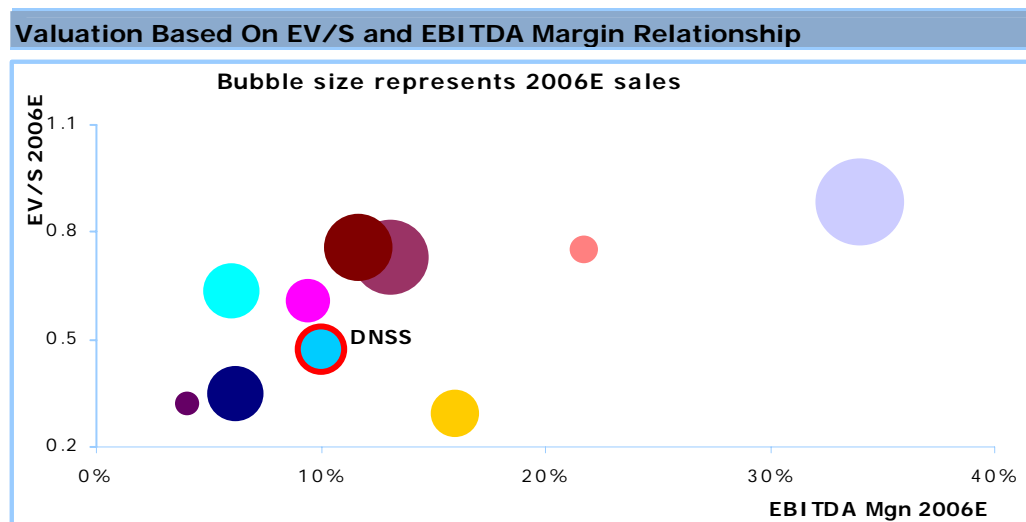
### Peer Comparison

Relative valuation of DniproSpetsStal yields a range of implied share values from USD 87 to USD 378 per share, with most values bound within USD 210–289. The shortcomings of this method are due to different accounting standards used by the companies being compared. Therefore, we find sales-based multiples as the most appropriate here.

Company	Sales USD mln		EBITDA USD mln		Net Income USD mln		EV/S		EV/EBITDA		P/E	
	2005E	2006E	2005E	2006E	2005E	2006E	2005E	2006E	2005E	2006E	2005E	2006E
<b>DniproSpetsStal</b>	<b>467.4</b>	<b>492.3</b>	<b>31.4</b>	<b>49.2</b>	<b>11.3</b>	<b>25.8</b>	<b>0.5</b>	<b>0.5</b>	<b>7.8</b>	<b>4.7</b>	<b>16.0</b>	<b>7.0</b>
BNG STEEL	656.0	667.4	25.4	41.2	8.1	12.3	0.3	0.3	8.4	5.7	8.8	5.8
NIPPON YAKIN KOGYO	1,118.5	1,230.3	146.5	161.2	150.6	165.6	0.8	0.7	6.1	5.6	2.6	2.4
NIPPON METAL INDUSTRY CO LTD	921.6	1,013.7	107.6	118.3	12.3	13.6	0.8	0.8	7.1	6.5	32.3	29.4
BAE MYUNG METAL	107.7	118.4	4.3	4.7	2.2	2.4	0.4	0.3	8.8	8.0	8.3	7.5
CHINA SPECIAL STEEL	109.0	179.3	23.6	39.0	16.8	27.0	1.2	0.8	5.7	3.5	5.8	3.6
ACESITA SA-PREF	1,551.3	1,706.4	527.4	580.2	325.8	358.3	1.0	0.9	2.9	2.6	3.6	3.2
AICHI STEEL CORP	1,390.6	1,529.7	132.4	145.6	40.4	44.5	1.5	1.4	15.9	14.4	48.6	44.2
NIPPON KINZOKU CO LTD	401.5	441.6	37.8	41.6	3.7	4.0	0.7	0.6	7.1	6.5	46.2	42.0
THAINOX STAINLESS PCL	447.7	492.5	71.6	78.8	54.6	60.1	0.3	0.3	2.0	1.8	4.1	3.8
DAYE SPECIAL STEEL	596.3	655.9	35.8	39.4	11.9	13.1	0.7	0.6	11.7	10.6	17.4	15.8
<b>Peer Average</b>							<b>0.8</b>	<b>0.7</b>	<b>7.1</b>	<b>6.1</b>	<b>17.8</b>	<b>15.8</b>
<b>Peer Median</b>							<b>0.8</b>	<b>0.7</b>	<b>7.1</b>	<b>5.7</b>	<b>8.3</b>	<b>5.8</b>
Implied MCap By Average, USD mln							300.1	280.0	158.1	245.9	200.8	406.0
Implied MCap By Median, USD mln							310.9	307.8	158.0	226.2	93.2	149.3
Implied Target Price By Average, USD							279.2	260.4	147.1	228.7	186.7	377.7
Implied Target Price By Median, USD							289.2	286.3	147.0	210.4	86.7	138.9

Source: Bloomberg, Thomson Financial; Company data; Concorde Capital estimates

As the relationship between EV/S and EBITDA margin below suggests, DNSS should trade at EV/S 2006E of ~0.45, implying USD 157.4 per share, which is marginally below current market price.



Source: Bloomberg; LME

## DCF Valuation

We project that by 2007 DniproSpetsStal will eradicate practicing related party transactions and resolve its most controversial ownership issues, which will be favorable for stable revenue growth. Our detailed projections are as follows:

### DniproSpetsStal's Projections

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
GDP growth	9.3%	12.0%	2.4%	4.0%	5.0%	4.5%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Industrial production growth	15.8%	12.5%	3.1%	5.0%	5.5%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
<b>Crude steel output, ths ton</b>	<b>344.4</b>	<b>502.4</b>	<b>506.2</b>	<b>534.0</b>	<b>544.7</b>	<b>555.6</b>	<b>566.7</b>	<b>578.0</b>	<b>589.6</b>	<b>601.4</b>	<b>613.4</b>	<b>625.7</b>
Rolled output ratio, %	62.8%	64.6%	66.5%	67.0%	67.0%	67.5%	67.5%	67.5%	67.5%	67.5%	67.5%	67.5%
Rolled & forged steel, ths mt	216.2	324.7	339.2	357.8	365.0	375.0	382.5	390.2	398.0	405.9	414.1	422.3
Est. avg. price, USD/mt	826.3	1,115.4	1,420.0	1,448.4	1,491.9	1,566.4	1,629.1	1,678.0	1,719.9	1,754.3	1,780.6	1,798.4
<b>True net revenue, UAH mln</b>	<b>952.7</b>	<b>1,926.5</b>	<b>2,509.1</b>	<b>2,591.1</b>	<b>2,722.3</b>	<b>2,937.3</b>	<b>3,115.9</b>	<b>3,273.6</b>	<b>3,422.5</b>	<b>3,560.8</b>	<b>3,686.5</b>	<b>3,797.8</b>
Unreported revenue, %	15.8%	15.8%	5.0%	5.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Revenue growth</b>		<b>102.2%</b>	<b>46.9%</b>	<b>3.3%</b>	<b>10.6%</b>	<b>7.9%</b>	<b>6.1%</b>	<b>5.1%</b>	<b>4.5%</b>	<b>4.0%</b>	<b>3.5%</b>	<b>3.0%</b>
<b>Net revenues, UAH mln</b>	<b>802.3</b>	<b>1,622.4</b>	<b>2,383.6</b>	<b>2,461.6</b>	<b>2,722.3</b>	<b>2,937.3</b>	<b>3,115.9</b>	<b>3,273.6</b>	<b>3,422.5</b>	<b>3,560.8</b>	<b>3,686.5</b>	<b>3,797.8</b>
Gross margin, %	13.9%	21.4%	17.0%	17.0%	17.0%	16.0%	15.5%	15.1%	14.8%	14.7%	14.4%	14.2%
<b>Gross profit, UAH mln</b>	<b>111.5</b>	<b>348.0</b>	<b>405.2</b>	<b>418.5</b>	<b>462.8</b>	<b>470.0</b>	<b>483.0</b>	<b>494.3</b>	<b>504.8</b>	<b>521.7</b>	<b>530.9</b>	<b>539.3</b>
EBITDA margin, %	5.4%	10.4%	6.7%	10.0%	10.0%	9.0%	8.5%	8.1%	7.8%	7.7%	7.4%	7.2%
<b>EBITDA, UAH mln</b>	<b>43.2</b>	<b>168.8</b>	<b>160.0</b>	<b>246.2</b>	<b>272.2</b>	<b>264.4</b>	<b>264.9</b>	<b>265.2</b>	<b>265.2</b>	<b>272.4</b>	<b>272.8</b>	<b>273.4</b>
EBIT margin, %	0.1%	7.8%	5%	8%	9%	8%	7%	7%	7%	7%	6%	6%
<b>EBIT, UAH mln</b>	<b>0.7</b>	<b>125.8</b>	<b>119.2</b>	<b>206.3</b>	<b>233.2</b>	<b>225.9</b>	<b>226.8</b>	<b>227.8</b>	<b>228.6</b>	<b>236.6</b>	<b>237.8</b>	<b>239.4</b>
NI margin, %	-3.2%	5.5%	2.4%	5.2%	5.6%	5.0%	4.8%	4.7%	4.5%	4.4%	4.4%	4.3%
<b>Net income, UAH mln</b>	<b>(25.5)</b>	<b>89.9</b>	<b>57.2</b>	<b>128.3</b>	<b>153.3</b>	<b>147.2</b>	<b>150.2</b>	<b>152.6</b>	<b>152.9</b>	<b>158.1</b>	<b>162.2</b>	<b>164.9</b>
Dividend declared, UAH mln	-	-	-	38.5	92.0	88.3	90.1	91.5	107.0	110.7	113.6	115.4

Source: Company data; Concorde Capital estimates

The company's projected cash flows produce a current DCF-based value for the stock equal to USD 179.3. According to our analysis, in 12 months DniproSpetsStal's share should be worth USD 201.6.

### DniproSpetsStal's DCF Valuation

Valuation date

Feb 16 2006

For the purposes of forecasting local currency is used (UAH mln)

	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
<b>EBITDA</b>	<b>160</b>	<b>246</b>	<b>272</b>	<b>264</b>	<b>265</b>	<b>265</b>	<b>265</b>	<b>272</b>	<b>273</b>	<b>273</b>
EBIT	119	206	233	226	227	228	229	237	238	239
Tax Rate	30%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Taxed EBIT	83	155	175	169	170	171	171	177	178	180
Plus D&A	41	40	39	38	38	37	37	36	35	34
Less CapEx	(29)	(44)	(49)	(48)	(48)	(40)	(40)	(38)	(38)	(37)
Less change in OWC	(151)	(21)	(47)	(68)	(34)	(30)	(79)	(28)	(26)	(23)
<b>FCFF</b>	<b>-</b>	<b>129</b>	<b>118</b>	<b>93</b>	<b>127</b>	<b>139</b>	<b>89</b>	<b>147</b>	<b>150</b>	<b>154</b>
WACC		15.7%	15.3%	14.7%	14.2%	13.7%	12.9%	12.7%	12.3%	12.4%
WACC to Perpetuity		11%								632
Firm Value		1,244								50.8%
Less Net Debt		(318)								3.0%
Plus Non-Operating assets		38								7.3x
Equity Value		964	1,084							
<b>Fair Value per Share, USD</b>		<b>179.3</b>	<b>201.6</b>							

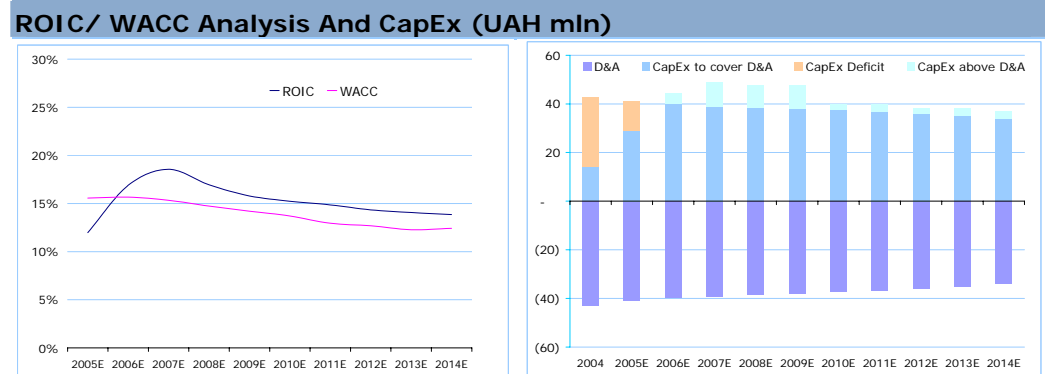
Source: Company data; Concorde Capital estimates

We favor the DCF approach over relative valuation as a more fundamental approach. In addition, our DNSS stock values obtained by peer comparison produce too wide a range making it difficult to determine the stock's fair value.

Upside implied by the DCF valuation totals 20%.

### Return On Investments

We project that the company's ROIC will gradually decline due to production cost growth, but so will WACC reflecting lower perceived risk. These two factors contribute to the robustness of our DCF valuation.



Source: Company data; Concorde Capital estimates

## Appendix

### DniproSpetsStal's Products



#### Structural steel

Divides into

- quality structural carbon steel (low content of impurities, carbon, Si and Mn) which is used in welded structures such as bridges and machine parts bearing high mechanical loads.
- alloyed structural steel (low carbon content and alloy content of up to 7%; alloying elements used are Mn, Si, Cr, Ni, Va, Zr and copper) which is used in the construction industry, basic engineering, machine building, transport and automotive industries due to its high strength and weldability.



#### Stainless steel

Refers to a number of different steels containing a minimum of 10.5% Cr (by mass) and used primarily for its resistance to corrosion. Ni and Mo are usually added to improve anti-corrosion properties. Industries that need stainless steel are pipe (tubular billets), chemical, petrochemical, food, medical, railcar building, agricultural machine building, motor and others.



#### Tool steel

A group of steel grades that are very hard, strong and durable due to heat treatment. Divides into carbon tool steel (non-heat resistant), and heat resistant alloyed and high-speed tool steels. These steels are used to produce measuring tools, cutting tools and die steel products for further hot rolling or cold drawing.



#### Bearing steel

Used for the production of bearings for tools, cars, railway cars, aircraft engines etc. Targeted properties are high hardness, wear resistance and contact strength so that finished bearings could meet precision, durability and reliability standards.



#### Spring steel

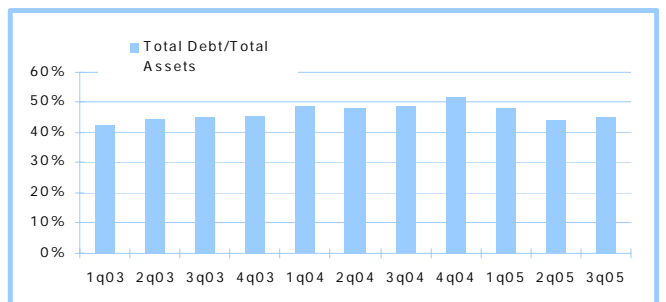
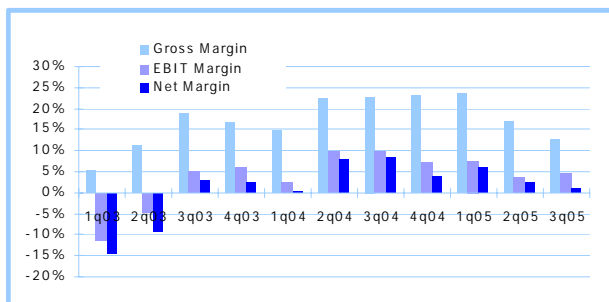
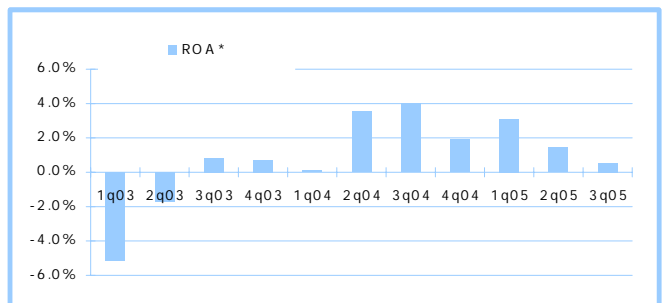
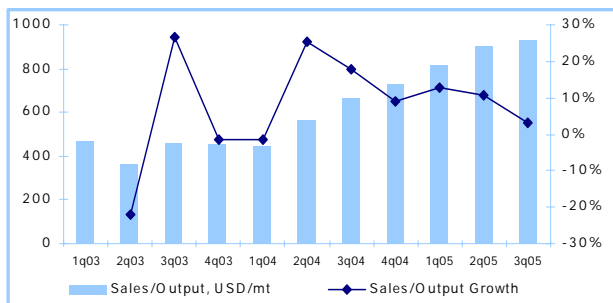
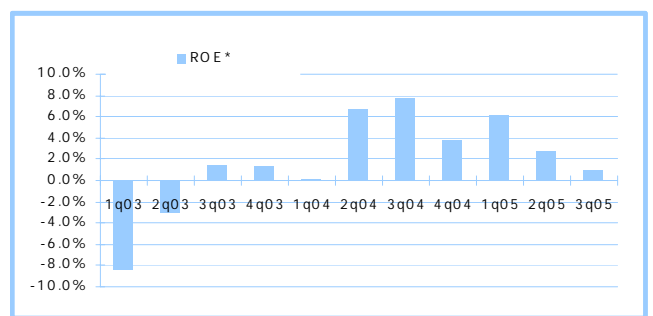
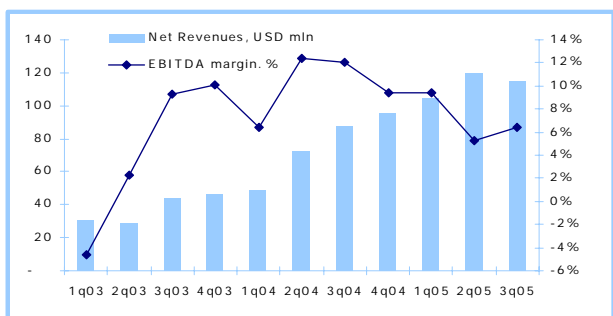
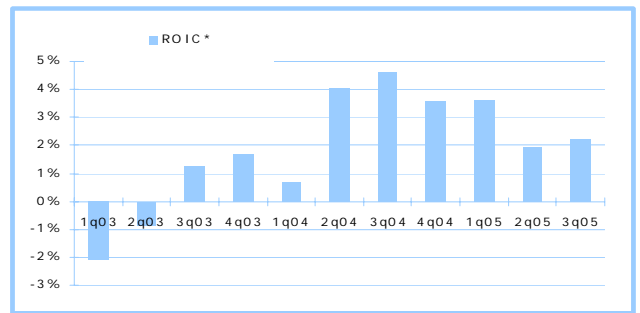
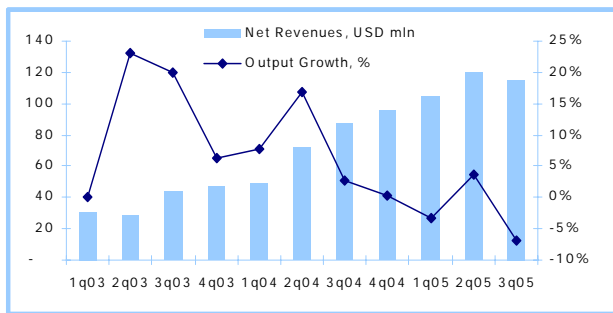
Characterized by high high elasticity and strength. These are achieved through a special heat treatment (i.e. patenting). Used for the production of different spring-like products.



#### Heat-resistant steel

These are silicochrome and chromium-nickel steels which are able to withstand extreme heat. They are used in the production of different parts for the aerospace industry (jet engines), ship building, in the oil industry and in metallurgy.

# Company Quarterly Analysis



\*Quarterly ROIC, ROE and ROA are not annualized



# DniproSpetsStal's Financial Statements

All financial statements according to Ukrainian Accounting Standards

## Income Statement Summary, USD mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
<b>Net Revenues</b>	<b>150</b>	<b>305</b>	<b>467</b>	<b>492</b>	<b>544</b>	<b>587</b>	<b>623</b>	<b>655</b>	<b>684</b>	<b>712</b>	<b>737</b>	<b>760</b>
<i>Change y-o-y</i>	7%	103%	53%	5%	11%	8%	6%	5%	5%	4%	4%	3%
Cost Of Sales	(130)	(240)	(388)	(409)	(452)	(493)	(527)	(556)	(584)	(608)	(631)	(652)
Gross Profit	21	65	79	84	93	94	97	99	101	104	106	108
Other Operating Income/Costs, net	(3)	(22)	(19)	-	-	-	-	-	-	-	-	-
SG&A	(10)	(12)	(29)	(34)	(38)	(41)	(44)	(46)	(48)	(50)	(52)	(53)
<b>EBITDA</b>	<b>8</b>	<b>32</b>	<b>31</b>	<b>49</b>	<b>54</b>	<b>53</b>	<b>53</b>	<b>53</b>	<b>53</b>	<b>54</b>	<b>55</b>	<b>55</b>
<i>EBITDA margin, %</i>	5.4%	10.4%	6.7%	10.0%	10.0%	9.0%	8.5%	8.1%	7.7%	7.6%	7.4%	7.2%
Depreciation	(8)	(8)	(8)	(8)	(8)	(8)	(8)	(7)	(7)	(7)	(7)	(7)
<b>EBIT</b>	<b>0</b>	<b>24</b>	<b>23</b>	<b>41</b>	<b>47</b>	<b>45</b>	<b>45</b>	<b>46</b>	<b>46</b>	<b>47</b>	<b>48</b>	<b>48</b>
<i>EBIT margin, %</i>	0.1%	7.8%	5.0%	8.4%	8.6%	7.7%	7.3%	7.0%	6.7%	6.6%	6.5%	6.3%
Interest Expense	(5)	(5.5)	(7)	(7)	(6)	(6)	(5)	(5)	(5)	(5)	(4)	(4)
Financial income/(expense)	0	0	-	-	-	-	-	-	-	-	-	-
Other income/(expense)	(0)	1	-	-	-	-	-	-	-	-	-	-
<b>PBT</b>	<b>(4)</b>	<b>19</b>	<b>16</b>	<b>34</b>	<b>41</b>	<b>39</b>	<b>40</b>	<b>41</b>	<b>41</b>	<b>42</b>	<b>43</b>	<b>44</b>
Tax	(0)	(2)	(5)	(9)	(10)	(10)	(10)	(10)	(10)	(11)	(11)	(11)
<i>Effective tax rate</i>	-8%	12%	30%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Extraordinary Income/(loss)	-	-	-	-	-	-	-	-	-	-	-	-
<b>Net Income</b>	<b>(5)</b>	<b>17</b>	<b>11</b>	<b>26</b>	<b>31</b>	<b>29</b>	<b>30</b>	<b>31</b>	<b>31</b>	<b>32</b>	<b>32</b>	<b>33</b>
<i>Net Margin, %</i>	-3.2%	5.5%	2.4%	5.2%	5.6%	5.0%	4.8%	4.7%	4.5%	4.4%	4.4%	4.3%
<b>Dividend Declared</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>8</b>	<b>18</b>	<b>18</b>	<b>18</b>	<b>18</b>	<b>21</b>	<b>22</b>	<b>23</b>	<b>23</b>

## Balance Sheet Summary, USD mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
<b>Current Assets</b>	<b>50</b>	<b>110</b>	<b>123</b>	<b>142</b>	<b>157</b>	<b>175</b>	<b>186</b>	<b>195</b>	<b>207</b>	<b>216</b>	<b>223</b>	<b>230</b>
Cash & Equivalents	1	1	1	1	2	2	2	2	2	2	2	2
Trade Receivables	5	21	21	22	25	26	28	29	31	32	33	34
Inventories	26	46	57	59	65	70	75	79	82	85	88	91
Other current assets	18	42	43	59	65	76	81	85	92	96	100	103
<b>Fixed Assets</b>	<b>102</b>	<b>95</b>	<b>98</b>	<b>99</b>	<b>101</b>	<b>103</b>	<b>105</b>	<b>105</b>	<b>106</b>	<b>106</b>	<b>107</b>	<b>108</b>
PP&E, net	79	75	77	77	77	79	82	84	85	86	87	88
Other Fixed Assets	23	19	21	23	24	24	23	22	21	20	20	20
<b>Total Assets</b>	<b>151</b>	<b>205</b>	<b>221</b>	<b>241</b>	<b>258</b>	<b>278</b>	<b>291</b>	<b>300</b>	<b>313</b>	<b>322</b>	<b>331</b>	<b>338</b>
<b>Shareholders' Equity</b>	<b>82</b>	<b>99</b>	<b>117</b>	<b>135</b>	<b>147</b>	<b>159</b>	<b>171</b>	<b>183</b>	<b>192</b>	<b>202</b>	<b>211</b>	<b>221</b>
Share Capital	9	9	9	9	9	9	9	9	9	9	9	9
Reserves and Other	99	99	106	106	106	106	106	106	106	106	106	106
Retained Earnings	(26)	(9)	2	20	32	44	56	68	77	86	96	106
<b>Current Liabilities</b>	<b>61</b>	<b>104</b>	<b>81</b>	<b>88</b>	<b>93</b>	<b>101</b>	<b>104</b>	<b>101</b>	<b>103</b>	<b>105</b>	<b>103</b>	<b>100</b>
ST Interest Bearing Debt	28	46	43	36	35	39	37	32	37	36	32	27
Trade Payables	13	20	20	25	33	41	44	46	48	50	52	53
Accrued Wages	1	1	2	2	3	3	3	3	3	4	4	4
Accrued Taxes	0	0	1	1	1	1	1	1	1	1	1	1
Other Current Liabilities	18	37	14	25	22	18	19	20	14	14	15	15
<b>LT Liabilities</b>	<b>8</b>	<b>2</b>	<b>24</b>	<b>18</b>	<b>18</b>	<b>18</b>	<b>16</b>	<b>16</b>	<b>18</b>	<b>16</b>	<b>16</b>	<b>16</b>
LT Interest Bearing Debt	8	2	24	18	18	18	16	16	18	16	16	16
Other LT	0	0	0	0	0	0	0	0	0	0	0	0
<b>Total Liabilities &amp; Equity</b>	<b>151</b>	<b>205</b>	<b>221</b>	<b>241</b>	<b>258</b>	<b>278</b>	<b>291</b>	<b>300</b>	<b>313</b>	<b>322</b>	<b>331</b>	<b>338</b>

## Cash Flow Statement Summary, USD mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Net Income	(5)	17	11	26	31	29	30	31	31	32	32	33
Depreciation	8	8	8	8	8	8	8	7	7	7	7	7
Non-operating and non-cash items	(4)	(5)	0	(0)	0	(0)	-	0	(0)	(0)	0	0
Changes in working capital	(4)	(40)	(30)	(4)	(9)	(14)	(7)	(6)	(16)	(6)	(5)	(5)
<b>Operating Cash Flow</b>	<b>(4)</b>	<b>(20)</b>	<b>(10)</b>	<b>29</b>	<b>29</b>	<b>24</b>	<b>31</b>	<b>32</b>	<b>22</b>	<b>33</b>	<b>34</b>	<b>35</b>
Capital Expenditures, net	(4)	(3)	(6)	(9)	(10)	(10)	(10)	(8)	(8)	(8)	(8)	(7)
Other Investments, net	0	16	-	-	-	-	-	-	-	-	-	-
<b>Investing Cash Flow</b>	<b>(4)</b>	<b>14</b>	<b>(6)</b>	<b>(9)</b>	<b>(10)</b>	<b>(10)</b>	<b>(10)</b>	<b>(8)</b>	<b>(8)</b>	<b>(8)</b>	<b>(8)</b>	<b>(7)</b>
Net Borrowings/(repayments)	9	11	16	(13)	(1)	4	(3)	(6)	7	(3)	(4)	(5)
Dividends Paid	-	(5)	-	(8)	(18)	(18)	(18)	(18)	(21)	(22)	(23)	(23)
Other	-	1	-	-	-	-	-	-	-	-	-	-
<b>Financing Cash Flow</b>	<b>9</b>	<b>7</b>	<b>16</b>	<b>(20)</b>	<b>(19)</b>	<b>(14)</b>	<b>(21)</b>	<b>(24)</b>	<b>(14)</b>	<b>(25)</b>	<b>(27)</b>	<b>(28)</b>
Beginning Cash Balance	1	1	1	1	1	2	2	2	2	2	2	2
Ending Cash Balance	1	1	1	1	2	2	2	2	2	2	2	2
<b>Net Cash Inflows/Outflows</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## UAH/USD Exchange Rates

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Average	5.33	5.30	5.10	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Year-end	5.33	5.30	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00

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