



CONCORDE CAPITAL

Ukraine / Electricity

# Donetskoblenergo

Restoring coverage

December 19, 2008

Current price: USD 1.0  
12M target: 3.6

**BUY**

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This week Rada prolonged bankruptcy shield of energy companies to Jan. 1, 2011. As a result, Donetskoblenergo has two more years to restructure its UAH 4.3 bln debt to Energorynok. Now that mid-term bankruptcy risk for Donetskoblenergo is minor, we restore DOON coverage by issuing BUY recommendation.

#### Tickers

Bloomberg DOON UZ

#### Market information

Market price, USD 1.0  
MCap, USD mln 65.5

No of shares, mln 65.52

Free float 6.3%  
Free float, USD mln 4.1

#### Corporate Governance

Concorde Rating\* P

\* The rating is based on Concorde Capital's corporate governance survey. Q denotes quality corporate governance standards, AA - above average standards, A - average, BA - below average and P - poor.

#### Shareholders

NC ECU (State) 65.1%  
DTEK 28.6%  
Other 6.3%

#### Key financials and ratios

	Sales, USD mln	EBITDA margin	Net margin
2007	465.3	-9.7%	-12.6%
2008E	491.0	8.2%	5.2%
2009E	466.5	8.2%	5.3%

	EV/S	EV/EBITDA	P/E
2008E	0.1	1.5	2.6
2009E	0.1	1.6	2.7

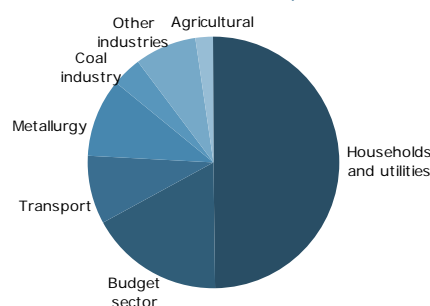
#### INVESTMENT CASE

- With prolongation of the moratorium on bankrupting energy companies until the end of 2010 (law #2711), risk of bankruptcy, which used to prevent DOON price growth, has dwindled. We believe the company will succeed in restructuring its outstanding payables over the next two years
- DOON has small share of industrial consumers (less than 25%) – this makes the company's sales relatively insensitive to the expected decrease in demand for power from industrial sector
- Progress in decreasing commercial power losses; as a result - 9M08 net income is UAH 120 mln (vs UAH 53 mln net losses for 9M07)
- A likely acquisition target by DTEK

#### Donetsk region on Ukrainian map

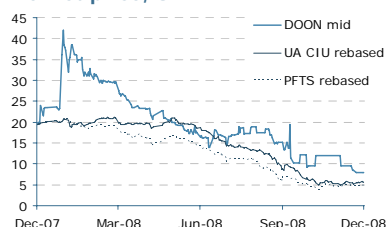


#### DOON consumer structure, 2007



Source: company data

#### Market price, UAH



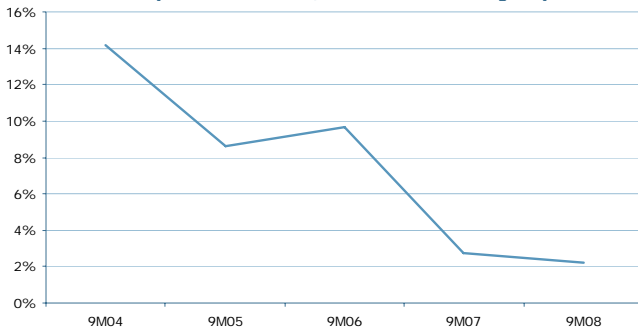
#### KEY FACTS ABOUT DONETSKOBLENERGO

- One of the three electricity distribution companies in Donetsk region; the least concentrated on industrial consumers among regional peers
- Total length of gridlines: 71.6 ths km, the largest in Ukraine
- Total transformer capacity: 11.6 GVA, the largest in Ukraine

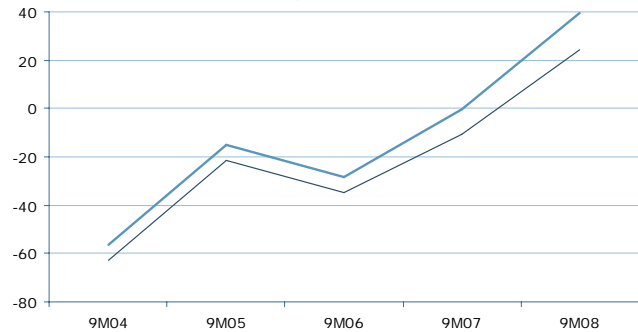
## Bottom line turns positive

Following the decade of loss-making work, Donetskoblenergo started reporting positive bottom line in 2008. The company managed to solve its problem of high commercial losses: current level of losses allows the company generating operating profit. We expect further increase of profits in 2009 thanks to continuing decline of commercial losses.

**Commercial power losses, % of electricity input**



**EBITDA and net income, USD mln**

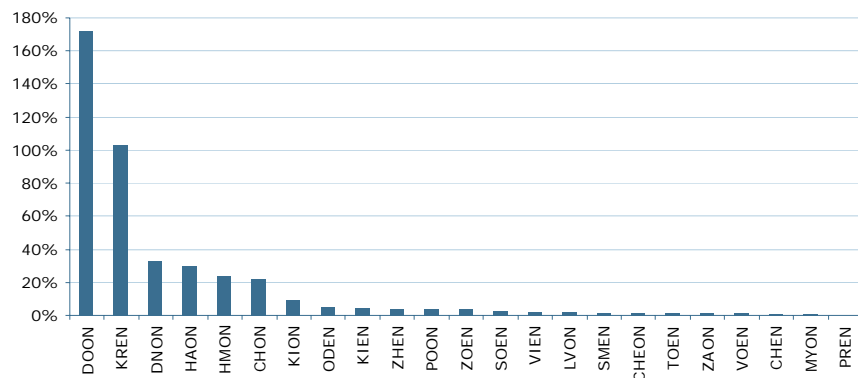


Source: Company data, Energobiznes

## Debt: two more years to restructure

With prolongation of the law protecting energy companies from bankruptcy, Donetskoblenergo, the most indebted electricity distribution company, has two more years to solve its problem of high outstanding payables. We see two possible ways of solving: signing restructuring agreement with Energorynok (the most probable scenario); or privatization of the company with investor's obligation to cover Donetskoblenergo's debt.

**Oblenergos' payables (Oct. 1 '08) to 9M08 sales**



Source: company data

The most realistic option is restructuring Donetskoblenergo's outstanding payables (UAH 4.2 mln) for 10 years (as is allowed by the law #2711) in late 2010, with even repayment since 2011. We consider two scenarios of repayment, with equal probability: 1) repayment from special surcharge to the company's tariff; 2) from Donetskoblenergo's operating profit.

## Valuation

For valuation purpose, we calculate two net debt measures which correspond to the two most probable scenarios of outstanding debt repayment, described above. Under the first scenario, we calculate net debt as net interest-bearing liabilities. Under the second scenario, we adjust net debt by adding UAH 1.6 bln (PV of restructured payables, assuming 15% discount rate).

### Peer valuation

Peer multiples		EV/S		EV/EBITDA		P/E		EV/Capacity
		2008	2009	2008	2009	2008	2009	USD/VA
EMASZ	HU	0.7	0.7	4.8	5.1	6.4	7.1	0.12
ELMU	HU	0.6	0.6	4.4	4.6	6.1	6.0	0.10
Prazska Energetika	CZ	1.5	1.5	6.3	6.3	9.9	9.7	0.19
Horizon Energy	NZ	3.9	4.2	8.3	8.9	15.0	14.5	0.28
Cegedel	LU	3.1	2.7	10.7	9.3	17.9	17.5	0.23
Elia	BE	5.3	5.2	12.4	12.2	16.1	15.8	n/a
Terna	IT	5.9	6.2	8.1	8.3	14.2	13.9	0.09
Central MRSK	RU	0.4	0.4	2.1	1.6	6.6	3.3	0.01
Ural MRSK	RU	0.3	0.2	2.2	1.5	2.9	2.5	n/a
<b>Peer average</b>		<b>2.4</b>	<b>2.4</b>	<b>6.6</b>	<b>6.4</b>	<b>10.6</b>	<b>10.0</b>	<b>0.15</b>
<b>Peer median</b>		<b>1.5</b>	<b>1.5</b>	<b>6.3</b>	<b>6.3</b>	<b>9.9</b>	<b>9.7</b>	<b>0.12</b>

### DOON multiples

@ net int.-bearing debt	0.1	0.1	1.5	1.6	2.6	2.7	0.01
@ adjusted net debt	0.7	0.7	8.1	8.5	2.6	2.7	0.03

### Implied DOON price, by peer median, USD

@ net int.-bearing debt	11.0	10.4	4.0	3.7	3.8	3.6	19.2
@ adjusted net debt	6.9	6.4	neg.	neg.	3.8	3.6	15.1

Source: Bloomberg, company data, Concorde Capital estimates

Implied price of DOON based on EV-related multiples is sensitive to assumption of net debt. To remain conservative and to ignore the effect of net debt assumption, we set 12M target price for DOON based on P/E multiple (USD 3.6).

Our target suggests a 260% upside to current mid-market price. Upside effective (adjusted for a 6-month spread, refer to our strategy note of Nov. 24, 2008) is 43%. We restore DOON coverage with a BUY recommendation.

# Disclosures

## 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	57	47%
Hold	47	39%
Sell	11	9%
Under Review	6	5%
<b>Total</b>	<b>121</b>	<b>100%</b>

### Investment banking clients\*

Buy	7	100%
Hold	0	0%
Sell	0	0%
Under Review	0	0%
<b>Total</b>	<b>7</b>	<b>100%</b>

*\*Within the last twelve month period, Concorde Capital has obtained compensation from these companies.*

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