



CONCORDE CAPITAL

# Ukraine / Coal machinery Druzhkivka Machinery

Riding High on Increased Demand

October 29, 2007

Current price: USD 0.64  
12M Target: USD 1.30

**BUY**

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Bloomberg **DRMZ UZ**

## Market information

Market price, USD	0.64
Chg YTD	141%
Hi/Lo YTD, USD	0.71/0.26
MCap, USD mln	132.4
No of shares, mln	207.5
Avg Mo Tr Vol YTD, USD mln	0.1
Free float	12.0%
Free float, USD mln	15.9

## 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.

## Stock ownership

SCM	65.3%
UID	12.0%
Portfolio investors	10.0%
Individuals	2.4%
Other	12.3%

**Druzhkivka Machinery, Ukraine's largest coal machinery producer, posted its highest profitability since 2002 and tripled sales yoy in 1H07. Ukraine's state energy program, which foresees investments of USD 44 bln by 2030 into state-owned mines, ensures stable demand in the long-term. SCM's plans to create a coal machinery holding including Druzhkivka is a mid-term booster. The stock's price has grown 69% over last three weeks; our new target price of USD 1.3 per share still offers a 103% upside.**

## 1H07 results surprise even the optimists

The company's 1H07 results firm up a financial recovery after four bad quarters from 3Q05-2Q06. Druzhkivka finished 2Q07 with a record high net margin of 12.5%, the fourth quarter in a row it showed improvement. We expect sales growth of 52% yoy in 2007 and a 9% net margin.

## Demand on the upswing

The major driver has been demand for coal machinery equipment from Ukraine and Russia. Increasing coal extraction and modernization of coal machinery in the CIS back long-term demand for Druzhkivka's products. In Ukraine, state plans to privatize state-owned coal mines in 2008 and private mines' CapEx programs should quicken the sector's modernization. We estimate management's plans, announced at their AGM in June, to diversify revenues into emerging markets (India, Iran and Vietnam) will contribute 10-15% annually to the company's sales.

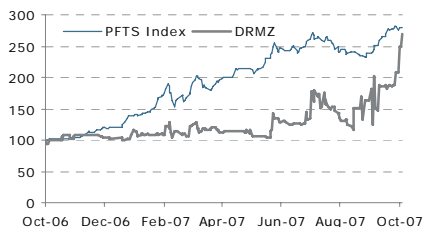
## Major part of SCM's future coal machinery holding

During our meeting with SCM representatives, we were told about their plans to create a coal machinery holding. We see Dongirmash, Svitlo Shahtarya, CJSC Gorlivskiy coal machinery plant and Druzhkivka Machinery as candidates for inclusion. It's clear that Druzhkivka would benefit from being united under one umbrella with SCM's coal mines and generation companies. On top of that, we expect SCM will take this holding public in the mid-term.

## Valuation suggests 100% upside

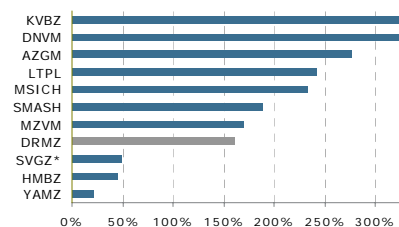
Based on peer multiples, we believe the DRMZ could double in price on the stock's strong momentum and overall bullish sentiment on the market. We reiterate our BUY recommendation with new 12M target price of USD 1.3 per share.

## Stock performance



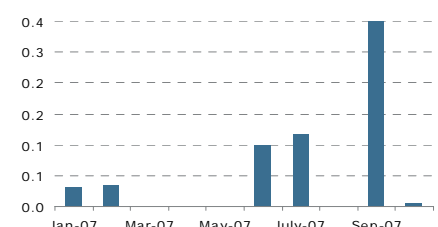
Source: Bloomberg, PFTS

## Sector performance YTD



\* MCap growth adjusted for SVGZ additional share issue

## PFTS Trading volumes, USD mln



## Key financials & ratios, USD mln

(in USD mln)	Sales	EBITDA Margin	Net Margin
2006	86	8.9%	2.7%
2007E	131	14.3%	9.0%
2008E	157	15.0%	9.5%

UAH/USD Spot exchange rate: 5.05

EV/S	EV/EBITDA	P/E
1.7	19.2	61.1
1.1	7.8	12.0
0.9	6.2	9.4

## Positive changes visible

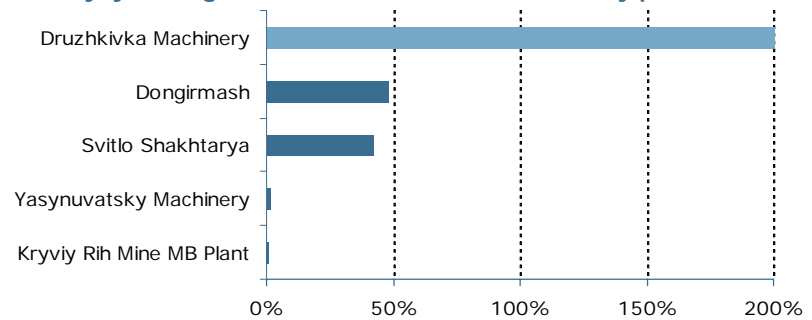
### P&L summary, USD mln

	1H05	1H06	1H07
Net Revenues	31.7	21.8	65.5
<i>Change y-o-y</i>	<i>-34.0%</i>	<i>-31.3%</i>	<i>200.7%</i>
Gross Profit	7.0	5.2	17.3
<i>Gross margin, %</i>	<i>22.1%</i>	<i>23.7%</i>	<i>26.4%</i>
EBITDA	2.7	1.2	9.4
<i>EBITDA margin, %</i>	<i>8.5%</i>	<i>5.5%</i>	<i>14.3%</i>
EBIT	1.5	-0.5	7.6
<i>EBIT margin, %</i>	<i>4.8%</i>	<i>-2.2%</i>	<i>11.6%</i>
Net Income	0.7	-1.8	5.9
<i>Net margin, %</i>	<i>2.3%</i>	<i>-8.2%</i>	<i>9.0%</i>

### Balance sheet summary, USD mln

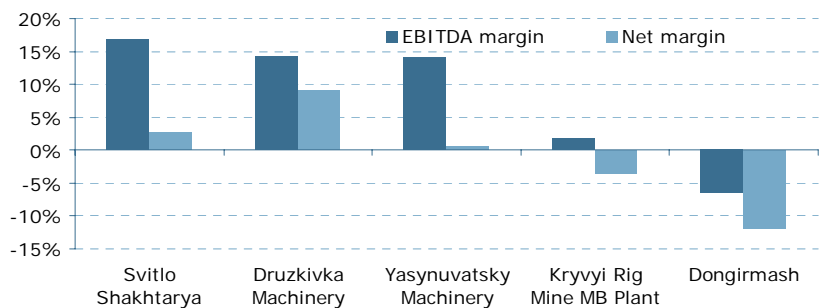
	1H05	1H06	1H07
Current Assets	78.9	97.4	178.2
Fixed Assets	35.1	35.9	36.3
Total Assets	114.0	133.3	214.6
Shareholders' Equity	35.0	32.8	35.0
Current Liabilities	79.0	100.5	179.5
LT Liabilities	-	-	-
Total Liabilities & Equity	114.0	133.3	214.6

### 1H07 yoy sales growth of Ukrainian coal machinery producers



Source: Company data

### 1H07 margins of Ukrainian coal machinery producers



Source: Company data

## Peer valuation

### Peer summary, USD mln

	Country	MCap, USD mln	Net Revenues			EBITDA margin			Net Margin		
			2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E
<b>Druzhkivka Machinery</b>		<b>132</b>	<b>86</b>	<b>131</b>	<b>157</b>	<b>9%</b>	<b>14%</b>	<b>15%</b>	<b>3%</b>	<b>9%</b>	<b>10%</b>
<b>International</b>											
Bucyrus International Inc	USA	3014	738	1584	2212	16%	15%	16%	10%	8%	8%
JOY Global Inc	USA	5689	2402	2521	2837	21%	20%	21%	17%	12%	12%
United Tractors	Indonesia	3426	1525	1784	2051	20%	19%	19%	7%	8%	8%
Anhui Heli Company	China	1566	321	463	611	16%	14%	14%	10%	9%	9%
Sandvik AB	Sweden	24446	10564	13323	14772	21%	21%	22%	11%	12%	12%
Shantui Construction Machinery	China	1636	392	553	714	13%	19%	18%	8%	12%	12%
<b>Peer average</b>						<b>18%</b>	<b>18%</b>	<b>18%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>
<b>Ukrainian Coal Machinery</b>											
Dongirmash	Ukraine	17	35	45	52	neg	neg	neg	neg	neg	neg
Kryviy Rig Mine Machine-Building	Ukraine	27	7	8	9	neg	2%	2%	neg	neg	0.1%
Svitlo shakhtarya	Ukraine	104	41	47	51	22%	17%	18%	14%	3%	10%
Yasynuvatsky Machinery	Ukraine	50	25	31	37	17%	21%	21%	9%	9%	9%
<b>Peer average</b>						<b>20%</b>	<b>13%</b>	<b>14%</b>	<b>12%</b>	<b>6%</b>	<b>6%</b>
<b>Ukrainian Machine-Building</b>											
Mariupol Heavy Machinery	Ukraine	329	502	521	536	2%	2%	2%	n/m	n/m	n/m
Azovzahalmash	Ukraine	497	325	429	472	3%	3%	3%	n/m	n/m	n/m
Stakhaniv Wagon	Ukraine	309	90	217	320	8%	7%	9%	2%	4%	4%
Kryukiv Wagon	Ukraine	818	225	400	440	13%	13%	14%	8%	8%	8%
Dniprovahonmash	Ukraine	124	96	137	164	7%	10%	13%	3%	5%	7%
Luhanskteplovov	Ukraine	336	88	165	321	7%	10%	10%	neg	5%	6%
Sumy Frunze	Ukraine	697	306	367	431	10%	13%	15%	5%	6%	8%
Motor Sich	Ukraine	572	245	333	379	16%	22%	23%	3%	9%	11%
<b>Peer average</b>						<b>8%</b>	<b>10%</b>	<b>11%</b>	<b>4%</b>	<b>6%</b>	<b>7%</b>

Source: Bloomberg, Company data, Concorde Capital estimates

### Peer multiples

	Country	Mcap, USD mln	EV/Sales		EV/EBITDA		P/E	
			2007E	2008E	2007E	2008E	2007E	2008E
<b>Druzhkivka Machinery</b>		<b>132</b>	<b>1.0</b>	<b>0.9</b>	<b>7.3</b>	<b>5.8</b>	<b>11.2</b>	<b>8.9</b>
<b>International</b>								
Bucyrus International Inc	USA	3 013.6	2.2	1.5	14.2	9.7	24.2	17.4
JOY Global Inc	USA	5 688.7	2.4	2.1	11.7	10.0	19.1	16.4
United Tractors	Indonesia	3 426.3	2.1	1.8	10.8	9.3	24.0	19.8
Anhui Heli Company	China	1 566.3	3.2	2.4	22.5	17.9	36.1	27.0
Sandvik AB	Sweden	24 445.6	2.1	1.8	9.7	8.4	15.9	13.9
Shantui Construction Machinery	China	1 636.4	n/a	n/a	n/a	n/a	25.3	19.6
<b>Average</b>			<b>2.4</b>	<b>1.9</b>	<b>13.8</b>	<b>11.1</b>	<b>24.1</b>	<b>19.0</b>
<b>Ukrainian Coal Machinery</b>								
Dongirmash	Ukraine	17	0.7	0.6	18.2	14.1	19.2	11.9
Kryviy Rig Mine Machine-Building Plant	Ukraine	27	3.4	3.0	n/m	n/m	n/m	n/m
Svitlo shakhtarya	Ukraine	104	1.9	1.7	11.3	9.4	82.2*	20.2
Yasynuvatsky Machinery	Ukraine	50	1.5	1.2	7.3	5.9	17.6	15.5
<b>Average</b>			<b>1.9</b>	<b>1.6</b>	<b>12.3</b>	<b>9.8</b>	<b>18.4</b>	<b>15.9</b>
<b>Ukrainian Machine-Building</b>								
Mariupol Heavy Machinery	Ukraine	329	0.7	0.7	n/m	n/m	n/m	n/m
Azovzahalmash	Ukraine	497	1.3	1.2	n/m	n/m	n/m	n/m
Stakhaniv Wagon	Ukraine	309	1.5	1.0	20.8	12.2	37.4	21.9
Kryukiv Wagon	Ukraine	818	2.0	1.9	15.3	13.7	25.0	22.1
Dniprovahonmash	Ukraine	124	1.1	0.9	10.9	7.0	18.1	10.8
Luhanskteplovov	Ukraine	336	2.2	1.1	22.7	11.1	40.7	19.0
Sumy Frunze	Ukraine	697	2.0	1.7	15.9	11.4	31.6	20.2
Motor Sich	Ukraine	572	1.7	1.5	7.5	6.5	19.1	13.7
<b>Average</b>			<b>1.6</b>	<b>1.2</b>	<b>15.5</b>	<b>10.3</b>	<b>28.7</b>	<b>18.0</b>
<b>International</b>								
Implied DRMZ price, USD			1.5	1.4	1.2	1.2	1.4	1.4
Implied/Upside			133%	127%	92%	93%	115%	114%
<b>Ukrainian Coal Machinery</b>								
Implied DRMZ price, USD			1.2	1.2	1.1	1.1	1.0	1.1
Implied/Upside			83%	90%	70%	70%	64%	79%
<b>Ukrainian Machine-Building</b>								
Implied DRMZ price, USD			1.0	0.9	1.4	1.1	1.5	1.3
Implied Upside			51%	44%	116%	80%	139%	106%

Source: Bloomberg, Company data, Concorde Capital estimates

### Druzhkivka Machinery P&L quarterly summary, USD mln

	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07
<b>Net Revenues</b>	<b>14.2</b>	<b>17.5</b>	<b>16.9</b>	<b>41.8</b>	<b>9.9</b>	<b>11.9</b>	<b>32.8</b>	<b>30.9</b>	<b>21.8</b>	<b>43.7</b>
Change y-o-y	12%	-51%	-64%	49%	-31%	-32%	94%	-26%	121%	267%
<b>EBITDA</b>	<b>1.2</b>	<b>1.5</b>	<b>2.0</b>	<b>1.9</b>	<b>0.6</b>	<b>0.6</b>	<b>3.8</b>	<b>2.6</b>	<b>2.0</b>	<b>7.4</b>
EBITDA margin, %	8.3%	8.8%	11.7%	4.5%	6.3%	4.8%	11.6%	8.4%	9.2%	16.9%
<b>EBIT</b>	<b>0.6</b>	<b>0.9</b>	<b>0.0</b>	<b>0.8</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>2.9</b>	<b>1.7</b>	<b>1.1</b>	<b>6.5</b>
EBIT margin, %	4.1%	5.3%	0.2%	1.9%	-2.2%	-2.3%	8.8%	5.4%	5.2%	14.9%
<b>Net Income</b>	<b>0.2</b>	<b>0.6</b>	<b>(0.3)</b>	<b>(0.1)</b>	<b>(0.6)</b>	<b>(1.2)</b>	<b>2.5</b>	<b>1.6</b>	<b>0.4</b>	<b>5.5</b>
Net Margin, %	1.2%	3.3%	-1.9%	-0.3%	-5.8%	-10.1%	7.7%	5.0%	1.9%	12.5%

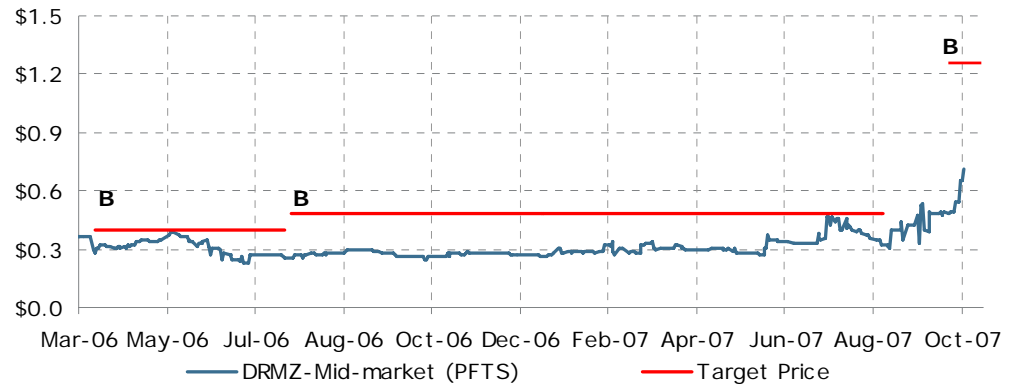
Source: Company data

## Analyst certification

I, Inna Perepelytsya, 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.

Date	Target price, USD	Market Price, USD	Rec'	Action
14-Mar-06	0.40	0.34	BUY	Initiating
25-Jul-06*	0.48	0.22	BUY	Maintain
29-Oct-07	1.3	0.64	BUY	Maintain

\* Until January 2007 the company was covered by Eugene Cherviachenko, who now focuses on another sector. In February 2007, Inna Perepelytsya took over coverage.



### Concorde Capital rating universe

Buy	37	46%
Hold	25	31%
Sell	7	9%
Under Review/Suspended	12	15%
<b>Total</b>	<b>81</b>	<b>100%</b>

### Investment Banking clients

Buy	9	75%
Hold	3	25%
Sell	0	0%
Under Review/Suspended	0	0%
<b>Total</b>	<b>12</b>	<b>100%</b>

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