



CONCORDE CAPITAL

Ukraine / Electricity Power Generation

Gas Units Resurrected

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	12M target, USD		Rec.
	Old	New	
Centrenergo	3.2	4.2	HOLD
Dniproenergo	410.0	410.0	HOLD
Donbasenergo	27.6	27.6	HOLD
Zakhidenergo	94.3	94.3	HOLD

FY 2007 forecast revision

	Sales, USD mln	
	Old	New
Centrenergo	605	609
Dniproenergo	690	694
Donbasenergo	305	299
Zakhidenergo	710	710
Vostokenergo	840	856

	EBITDA margin	
	Old	New
Centrenergo	15%	10%
Dniproenergo	17%	12%
Donbasenergo	16%	8%
Zakhidenergo	10%	7%
Vostokenergo	28%	25%

Gas-fueled units relaunched

In August Centrenergo and Dniproenergo restarted their gas-fueled power units that had been idle since 2004. The new units offset the reduction of output at coal-fueled power units at TPPs, which was restricted because they failed to increase coal stockpiles in line with new rules by the National Electricity Regulation Commission.

Tougher NERC regulation

This event is rooted in a June 2007 NERC decree that ordered a mandatory increase in coal stockpiles for all Ukrainian thermal power plants by more than four times. We see a high likelihood that compliance will eat away most of GenCos' 3Q07 EBITDA, forcing a deterioration in FY2007 operating profits.

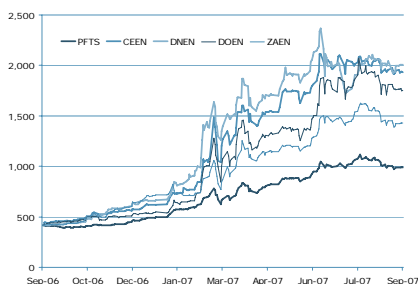
Effective installed capacity upgraded

Nevertheless, in pulling the gas blocks out of mothballs showed us that we were too conservative in not accounting for gas-fueled power units in our calculations of the capacity base for GenCos. The reality is that these power units, as expensive as they may be, might be relaunched whenever the NERC has a reason for to. For valuation purposes, we add back 1/3 of the gas-fueled power capacity of Centrenergo and Dniproenergo to our total capacity calculation.

The sector is on HOLD

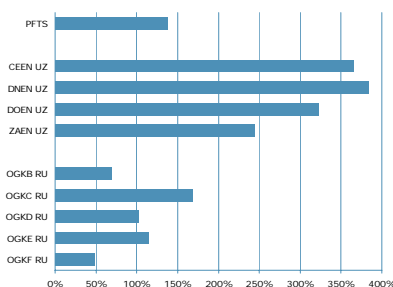
Increased capacity gave us grounds to upgrade our 12M target for CEEN to USD 4.2. In regards to DNEN, we already accounted for this effect when updating its 12M target a week ago. We believe the whole generation segment trades at fair valuations after the recent market correction, and confirm our HOLD recommendations for all four GenCos.

PFTS vs. GenCos rebased

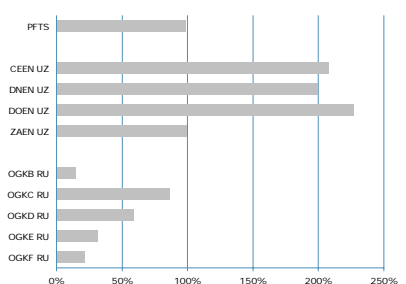


Source: PFTS, RTS

Performance, 52 week



Performance, YTD



Amended rules of the energy market

Increase in coal stockpile requirements of TPPs

According to energy market rules, which were revised in June 2007, all thermal power plants must accumulate coal stockpiles amounting to 170-450 ths mt by October 1, 2007 (previously only 20-70 ths mt was required). The NERC issued a schedule for coal stockpile accumulation so that TPPs will reach this target, and is limiting the work of power plants that do not meet the schedule.

Actual and required coal stockpiles at power plants, ths mt

	Actual coal stockpile, July 1, 2007	Required coal stockpile Oct. 1, 2007	Required increase of stockpiles, Jul-Oct
DNEN	367.5	775	407.5
Kriviy Rih	59.2	250	
Prydniprovsk	161.4	250	
Zaporizhia	146.9	275	
DOEN	209.4	525	315.6
Starobeshev	127	275	
Slaviansk	82.4	250	
VSEN	395.5	750	354.5
Zuiv	104.7	250	
Kluhansk	190.5	225	
Kurakhov	100.3	275	
ZAEN	708.8	870	161.2
Burshtyn	364.5	450	
Dobrotvir	113.7	170	
Ladyzhyn	230.6	250	
CEEN	425.8	800	374.2
Uglegorsk	291.8	275	
Zmiiv	83.7	275	
Trypillia	50.3	250	

Source: Energobiznes, NERC, Concorde Capital calculations

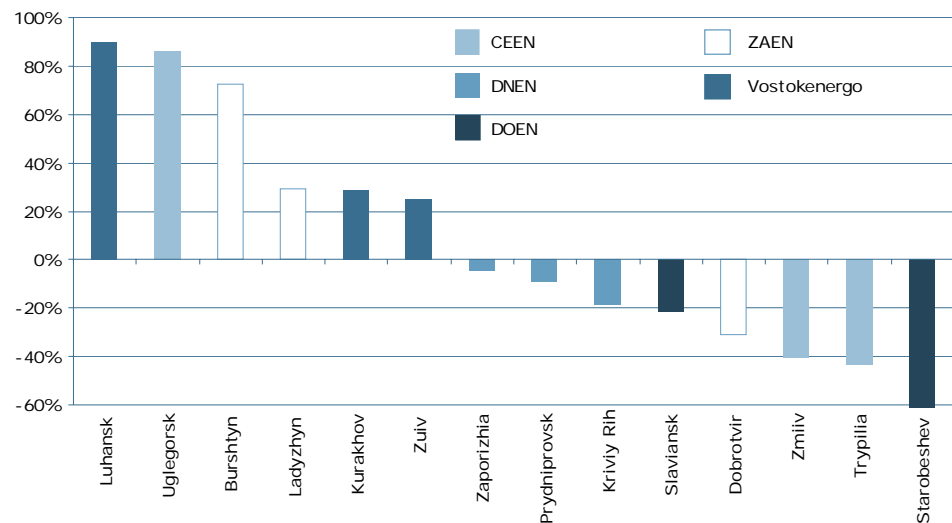
Implications of the new regulation

The NERC's new rules have short-term implications for GenCos and will most likely only affect 2007 operating results. We not foresee any impact on operations in the mid-term.

Vostokenergo benefits

It has not been an easy task for state-controlled GenCos to double the coal supplies to their power plants (partially because coal mines were not ready to satisfy increased demand) - most power plants have failed to meet the NERC's schedule. According to new rules, the dispatcher limited their output.

Extent to which TPPs met the coal accumulation schedule*: July 31, 2007



Source: *Energobiznes*, NERC, Concorde Capital calculations
 * Ratio of actual coal deposits and required coal stockpiles

With coal supplies sourced from related private mines, all of Vostokenergo's power plants met the NERC's accumulation schedule and are now working close to their full capacity. Meanwhile, most state-controlled power plants have been sanctioned and are working at near their minimum load. This naturally leads to speculation that Vostokenergo's owners (which have high lobbying power with the energy market regulators) could have been the initiators of the *new rules*, which might be revenge on state GenCos for artificial limiting Vostokenergo's output in 2005 (refer to our GenCos report of September 2005). Though, the price paid by Vostokenergo for this revenge (see next page) fails to justify our suspicion.

Gas-fueled power gets a chance to work

Since the **majority** of power plants failed to meet the coal accumulation schedule, limitations could not be applied without the emergence of an electricity supply deficit on the market. Regulators decided to fill the gap by allowing gas-fueled power units, which had been idle for the last three years, to be restarted.

Gas-fueled power units' working schedule, Aug. 1 – Sept. 9, 2007

Company	Power unit	Capacity, MW	Worked days, Aug 01-Sept 06
Dniproenergo			
	Zaporizhia TPP		
	Unit #5	800	-
	Unit #6	800	-
	Unit #7	800	19
Centrenergo			
	Uglegorsk TPP		
	Unit #5	800	-
	Unit #6	800	15
	Unit #7	800	-
	Trypillia TPP		
	Unit #5	300	11
	Unit #6	300	-

Source: Energorynok

Electricity produced at Ukrainian TPPs from gas is 20%-25% more expensive than coal-fueled power units, prompting the regulator to buy electricity from gas-fueled power units at above the market price.

We believe the fact that some of Centrenergo's and Dniproenergo's gas-fueled power units are operational will not have a material implication in the mid-term. The operation of gas-fueled power units is temporary: the NERC has only allowed them to work in August & September 2007. They might be permitted to remain operational for part of October 2007, but when the TPPs accumulate needed coal stockpiles, they will be idled again.

This event revealed that gas-fired power units are in workable condition, and we believe they might be restarted again in the long-term when demand for electricity grows. While we previously ignored gas-fueled capacity in our valuation, we now augment the total capacity of Dniproenergo and Centrenergo by adding 1/3 of the capacity of their gas-fueled power units.

Implication for GenCos' financials: FY07 margins to decrease

To accumulate stockpiles and purchase coal for operations, GenCos *need to spend an additional USD 16 mln to USD 31 mln by October 1*. We expect this **will lead to negative or close to zero 3Q07 EBITDA** for all GenCos except Vostokenergo. As we do not believe that every TPP will be able to accumulate the required stockpile by October 1, 2007 (due to possible cash deficits), we expect the negative effect on EBITDA to be split over the two last quarters of 2007.

Expected cost of coal accumulation

	USD mln	% of 2007E Sales	% of 2Q07 EBITDA
CEEN	29	-4.8%	-110%
DNEN	31	-4.6%	-112%
DOEN	23	-7.4%	-215%
ZAEN	16	-2.3%	-126%
Vostokenergo	31	-3.6%	-55%

Source: Energobiznes, NERC, company data, Concorde Capital estimates

Regulations are most likely to lead to a decrease in GenCos' full year EBITDA margins by 2.3%-7.4%: we revise our FY2007 forecast for GenCos.

Valuation

All our findings (except the revision in gas-fueled capacity) have no implication on GenCos' targets, as we use capacity-based metrics for valuation. As a one-time event, changes in profitability will not affect the mid-term results of GenCos.

All the GenCos trade in a very narrow range of USD 305-340/kW by EV/capacity. We believe the generation sector is priced fairly.

Valuation by local peers

	MCap USD mln	Net debt USD mln	Capacity MW	EV/Capacity USD/kW
CEEN	1,522	359.7	5,950	316
DNEN	2,226	-75.7	6,560	328
DOEN	658	169.8	2,710	305
ZAEN	1,364	233.5	4,700	340

Centrenergio: HOLD

Accounting for the capacity boost at Centrenergio led us to increase our 12M target for the stock to USD 4.2. We reiterate our HOLD recommendation.

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