GenCos

Cheap stocks burdened by an uncertain regulatory environment

1H11 financials impressive but not yet sustainable

Driven by the hike in electricity selling prices in 2Q11, GenCos increased their EBITDA margins by 6-12 pp in 1H11 from 1Q11. We see the profitability improvement as a temporary sector-wide trigger.

Mid-term prospects still vague, we only recommend going long in GenCos

Despite the impressive 2Q11 profits and the scheduled privatization of Zakhidenergo and Dniproenergo, which could improve sentiment, we believe full-year financials will be less stellar and view mid-term profitability prospects as vague. We still view GenCos as a pure asset-play, able to reveal their fundamental value only given a relatively long investment horizon, as both full sector privatization and regulatory clarity requires at least three years.

Ukraine sports among world's most cheaply priced generation assets

The key reason to invest in Ukrainian GenCos is the fact that they are the cheapest electricity generation stocks in the world if measured by capacity – the four stocks representing the local universe are priced at USD 68-149 per kW of capacity versus USD 183-711 for Russian peers and USD 700-1,500 range for global peers. Though some discount is justified by low profitability and regulatory uncertainty in Ukraine, we consider current discounts excessive even when coupled with a discount for a relatively low liquidity and general country risk.

Depressed market creates attractive entry point

GenCos fell 18%-35% vs. the UX's 17% decline during a bearish April-July 2011. We attribute the underperformance to disappointment over delays in privatization and regulatory reform. With our strong belief that Zakhidenergo and Dniproenergo's privatization is only a matter of timing and will take place by yearend as scheduled, we see current prices as a very attractive entry point. We rate three of the four GenCos BUY.

Report date				**2 August 2011**
Bloomberg	CEEN UK	DNEN UK	DOEN UK	ZAEN UK
Recommendation	**BUY**	**BUY**	**BUY**	**HOLD**
Price, USD	1.62	96.4	5.9	39.2
12M price target, USD	2.6	155	14.5	47
Upside, %	61%	60%	145%	20%
No of shares, mln	369.4	5.97	23.6	12.8
Market Cap, USD mln	597.0	575.1	139.8	501.1
52-week performance	-14%	-32%	-34%	-44%
52-week range, USD	1.4/2.5	172/88	5.7/10.5	72/37
ADT, 12M, USD mln	0.9	0.1	0.2	1.4
Free float, %	21.7%	2.5%	14.2%	4.0%
Free float, USD mln	129.6	14.1	19.9	20.0

Prices as of Aug. 1, 2011

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Sector update

Privatization announcements forthcoming in August-September

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.

1H11 financials impressive thanks to high electricity price in 2Q

The 6-12pp increase in EBITDA margins reported this week by GenCos in 1H11 from 1Q11 is due to the hike in electricity selling prices in 2Q11.

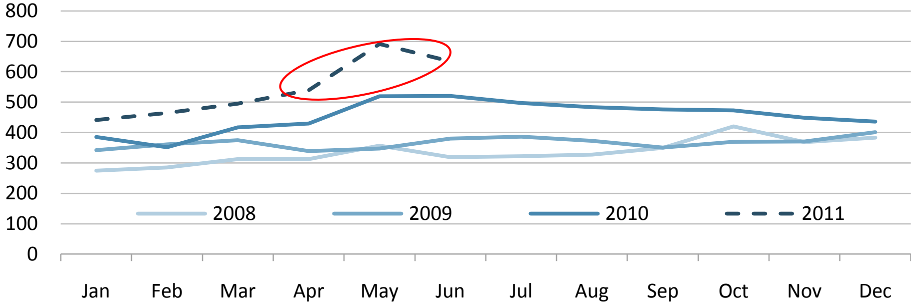
GenCo 1H11 financials, USD mln

	Centrenergo	Dniproenergo	Donbasenergo	Zakhidenergo
Revenues	393.9	519.1	221.3	454.1
y-o-y	*16%*	*56%*	*28%*	*66%*
EBITDA	35.0	79.7	8.8	45.4
EBITDA margin	*9%*	*15%*	*4%*	*10%*
EBITDA margin, y-o-y	4pp	2pp	4pp	9pp
Net income	17.3	41.7	0.2	34.0
Net margin	*4%*	*8%*	*0%*	*7%*

Source: Company data, Concorde Capital calculations

Full-year results should be less spectacular, in our view, as we expect the electricity selling price to recede by yearend, as it did last year. High coal prices and state intervention in electricity pricing should lead to lower margins for the year.

Electricity selling price by GenCos, UAH per MWh



Source: Energorynok

Regulations remain uncertain with virtually no action on reform

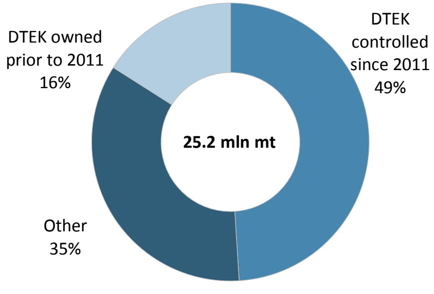
Contrary to our expectation, the government has taken virtually no action on electricity market reform. This has left open two key questions: (1) how will the variable electricity price be determined and (2) how will CapEx be paid back? This uncertainty, in our view, impedes interest in GenCo stakes offered up for privatization and should keep bids low. We maintain our view that sector reform will start only after the privatization of Dniproenergo and Zakhidenergo, which are the only two GenCos we believe of interest to local players with strong lobbying power.

Coal consolidation creates input-side risk for CEEN, DOEN

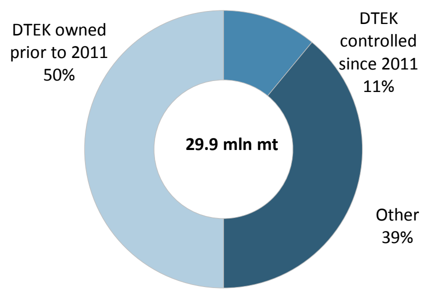
Over the last year, a number of deals have increased the market share of Ukraine's largest private player in coal extraction, DTEK. The energy holding, which controls Vostokenergo and minority stakes in Dniproenergo and Zakhidenergo, signed a 49-year lease agreement with Dobropolyeugol and five-year "investment agreements" with Rovenkyantracit and Sverdlovantracit. Though not formal ownership changes, we view DTEK as being able to execute operating control over the enterprises.

These transactions increase the long-term dependence of GenCos on one supplier (coal is more than 90% of fuel), which could decrease interest from potential bidders for the state's stakes in Centrenergo and Donbasenergo, since we expect the state to require significant purchases of coal from domestic suppliers. We also see a potential positive in increased coal extraction volumes under the superior management and CapEx provided by DTEK, which supports output growth by all Ukraine's GenCos.

Anthracite coal market, Ukraine, 2010



Gas coal market, Ukraine, 2010



Source: Energobusiness, Concorde Capital

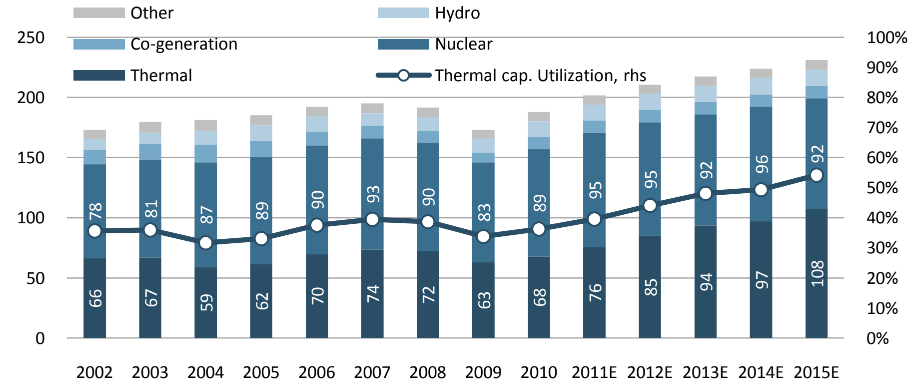
Long-term sector outlook

TPPs to satisfy fast growing demand for electricity

Ukraine's thermal power plants are the only generation assets in Ukraine with available capacity to meet mid-term growth in electricity consumption. Nuclear plants, the key domestic electricity source, have little room to ramp up production – they worked at 74% capacity in 2010, compared to their physical maximum of 85%. Furthermore, Ukraine has scheduled the decommissioning of 1.5 GW in nuclear capacity in the next five years and there are little to no capacity additions in the works.

Our forecast of growth in electricity consumption at a 4% CAGR in 2010-15 implies the need to boost aggregate domestic electricity production by 43 mln MWh per year, with 40 mln MWh of that provided by TPPs. This should help TPPs improve their share of total electricity output from 36% in 2010 to 47% in 2015.

Electricity production by fuel, bln kWh

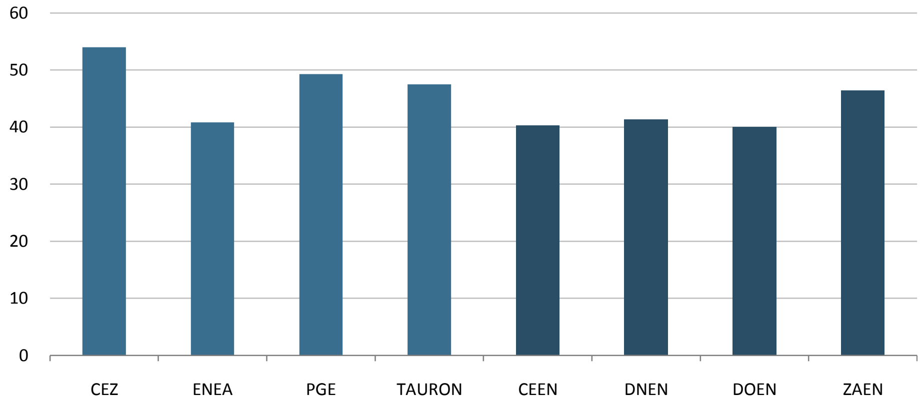


Source: Energobusiness, Concorde Capital projections

Electricity price hit EU levels in 2010

In 2010, Ukrainian GenCos electricity selling prices increased 22% y-o-y on average, reaching EUR 42 per MWh. This is close to those of producers in Eastern European Union countries – Poland's ENEA, Tauron and PGE sold at EUR 41-49 per MWh and Czech Republic's CEZ sold at EUR 54 per MWh.

Average electricity selling price, EUR per MWh, 2010



Source: Energobusiness, Company data, Concorde Capital calculations

Over the next five years, we expect electricity price growth to slow down to 30%, assuming coal price will stay at current levels.

Long-term sector outlook (cont.)

Margins remain uncertain

Despite growth in electricity selling prices, GenCos' long-term profitability is uncertain. The National Electricity Regulatory Commission's intervention in tariffs and state-owned GenCos' limiting prices have depressed the sector-wide selling price, which has left the whole sector barely breaking even in recent years. In 2010, all GenCos generated negative margins except for Dniproenergo, which had a lean net margin of 3%. In our view, the situation is most likely to improve only after long-awaited sector-wide reform. GenCos privatized by DTEK could get some support for their margins with discounted coal input costs from mines within the group, but un-privatized GenCos would still be dependent on DTEK's coal prices.

Low fuel efficiency has little prospects for change

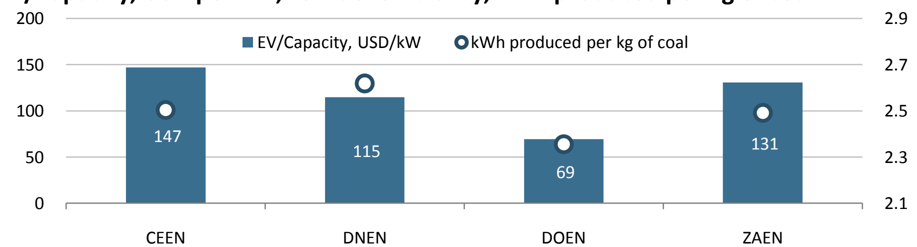
Ukraine's thermal electricity generation sector suffers from low fuel efficiency, which we do not expect to change without significant CapEx. Dniproenergo, the most fuel-efficient, consumed 382 g of fuel equivalent per KWh in 2010, which helped it to earn the highest margin in the sector, while Donbasenergo was the least efficient at 424 g of fuel equivalent per KWh. In the mid-term, we expect significant improvements only at Dniproenergo, the only listed GenCo with modernization projects in the pipeline.

Fuel efficiency, g of coal equivalent per kWh

	2005	2006	2007	2008	2009	2010	y-o-y
Centrenergo	408.6	404.5	391.3	401.7	397.8	399.4	0.4%
Dniproenergo	381.5	383.1	380.4	386.1	384.3	382.0	-0.6%
Donbasenergo	419.5	415.9	416.9	420.8	418.5	424.5	1.4%
Zakhidenergo	406.5	405.3	405.1	405.5	402.9	401.4	-0.4%
Vostokenergo	396.2	390.3	387.6	390.6	388.1	389.6	0.4%

Source: Energobusiness

EV/Capacity, USD per kW, vs. Fuel efficiency, kWh produced per kg of coal



Source: Bloomberg, Company data, Energobusiness

Capacity utilization remains low, but not for long

One of the reason behind GenCos' low ROE is low capacity utilization (36% in 2010). We expect this to change rapidly, based on our view that GenCos are set to absorb >90% of incremental demand increases due to low available capacity from other sources. Under our projection of thermal GenCos increasing output at a 10% CAGR in 2010-15, we expect sector capacity utilization to reach 54% in 2015.

Dniproenergo, thanks to its fuel efficiency, is poised to benefit more from additional demand, reaching 63% utilization, while the least efficient, Donbasenergo and Zakhidenergo, would move up to 43% and 45% load in 2015, respectively, according to our model.

Capacity utilization

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Nuclear	76%	76%	74%	68%	74%	81%	83%	85%	85%	85%
Thermal	38%	39%	39%	34%	36%	40%	44%	48%	49%	54%
Dniproenergo	30%	33%	32%	26%	31%	37%	44%	51%	53%	63%
Donbasenergo	32%	29%	31%	34%	35%	34%	36%	39%	39%	43%
Zakhidenergo	40%	39%	39%	33%	29%	32%	37%	41%	41%	45%
Centrenergo	35%	38%	39%	34%	37%	39%	43%	47%	48%	52%
Vostokenergo*	53%	58%	53%	46%	52%	56%	60%	61%	61%	62%

**Vostokenergo is a thermal GenCo 100%-owned by DTEK*
Source: Energobusiness, Concorde Capital forecasts

CapEx question

Unlike most other developing countries, Ukraine has sufficient electricity generation capacities to meet demand for the next 3-5 years. However, all Ukrainian TPPs were built in the 60s-70s, have worked 200-330 ths hours (vs. the normative 280 ths) and require modernization. Based on 19 implemented modernization projects, we estimate CapEx of USD 125-400 per kW are needed to prolong a plant's working by 15-20 years, reduce fuel consumption by 3-7% and increase a unit's maneuverability range by twofold. This is notably lower than the USD 1,500-1,800 per kW of CapEx required to build a new coal-fired power unit.

GenCos with large power units have modernization advantage

Based on an analysis of implemented projects, we estimate Ukrainian GenCos need to invest USD 175-269 per kW at current prices to overhaul their capacities in 2011-20. Our study indicates GenCos with large power units (300, 800 MW) are in a better position to upgrade since they require less CapEx due to efficiency of scale.

CapEx needed to modernize all power units

	Modernized capacities, MW	Capacities <280 MW	Capacities >280 MW	CapEx, USD mln	CapEx, USD/kW
Centrenergo	300	1,050	3,225	856	200
Dniproenergo	732	450	4,603	882	175
Donbasenergo	210	1,600	800	647	269
Zakhidenergo	185	2,415	1,800	1,071	254

Sources: Concorde Capital estimations

40% of CapEx covered by tariff surcharge

In Ukraine, significant modernization projects are partially covered by a special surcharge in their tariffs, a quasi-analogue to the new capacity premium applied in many energy markets. If a project is approved by the NERC, the company receives 70%-80% of the nominal value (73% in average) of the project over five years in the form of a surcharge. Our calculations show that the NPV of the FCFF from the investment surcharge covers 42% of CapEx at a 15% discount rate. The NERC's official position is that the current investment surcharge mechanism will remain in effect for the long-term, but we do not exclude the introduction of a more favorable mechanism.

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 a cash flow valuation model. We continue valuing GenCos via asset-based methods, a conservative approach, in our view.

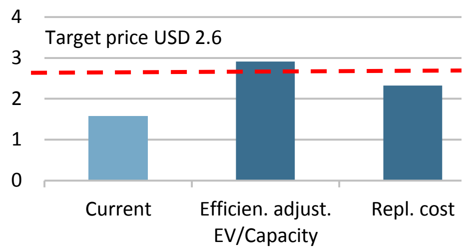
We average the results of a replacement cost model (which accounts for replenishment value adjusted for physical asset depreciation) and EV/Capacity comparison to Russian peers, with adjustments for relative efficiency (which we introduce in this report as both the Ukrainian and Russian market are sensitive 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

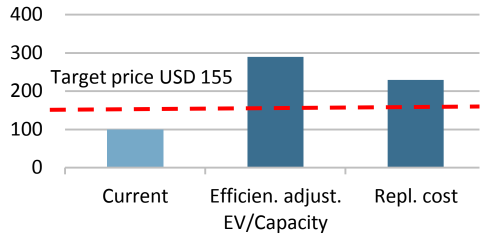
	Implied price per share						
	by EV/Capacity	by replacement cost model	Liquidity discount	Target price	Current price	Upside	Recom.
Centrenergo	2.9	2.3	0%	2.6	1.6	61%	BUY
Dniproenergo	287	229	-40%	155	96.4	60%	BUY
Donbasenergo	19.4	9.7	0%	14.5	5.9	145%	BUY
Zakhidenergo	59.0	58.7	-20%	47	39.2	20%	HOLD

Source: Bloomberg, Company data, Concorde Capital

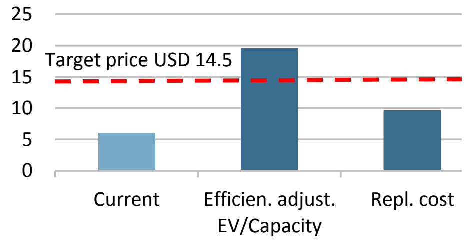
Centrenergo



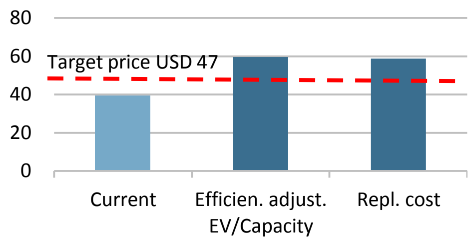
Dniproenergo



Donbasenergo



Zakhidenergo



Source: Bloomberg, Company data, Concorde Capital

Comparative valuation

We continue comparing GenCos to peers by the EV/Capacity multiple, which reflects how the market values one unit of generation capacity (in Ukraine, we take only coal-fired capacity, as gas-fired is idle due to high gas prices).

Ukrainian generation companies are trading in the range of USD 68-149 per kW of capacity, compared with USD 183-711 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.

Following our recent update on Dniproenergo and Zakhidenergo, in this report, we also 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
Centrenergo	1,147	0%	1,147	1,063	369.41	2.9
Dniproenergo	1,451	25%	1,814	1,710	5.97	286.5
Donbasenergo	666	-25%	499	458	23.64	19.4
Zakhidenergo	1,104	-25%	828	755	12.79	59.0

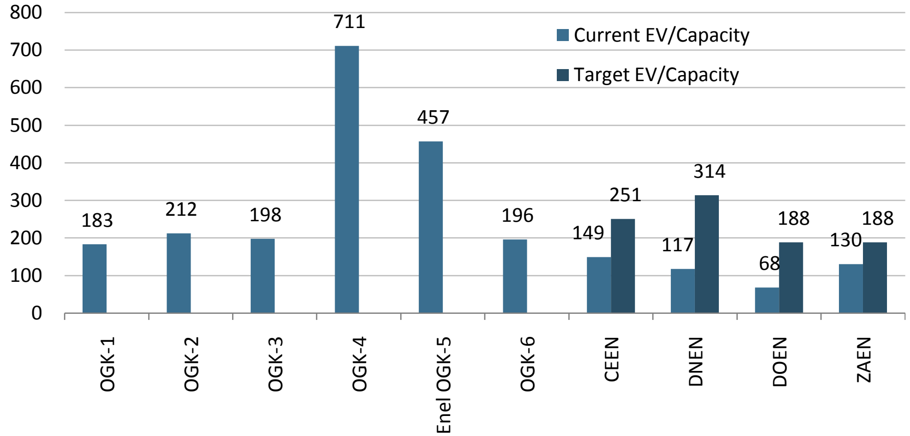
Source: Company data, Bloomberg, Concorde Capital

GenCos` multiples

	EV/S		EV/EBITDA		EV/Capacity		EV/MWh
	2011E	2012E	2011E	2012E	coal-fired	total capacity	USD per MWh
Centrenergo	0.7	0.6	14.7	7.5	149	90.0	44.2
Dniproenergo	0.6	0.4	4.9	2.8	117	83.0	43.8
Donbasenergo	0.4	0.3	37.7	6.3	68	68.4	20.6
Zakhidenergo	0.7	0.5	17.2	7.6	130	130.4	54.1
Harmonic mean	**0.6**	**0.4**	**11.3**	**5.1**	**107**	**88.0**	**35.5**
OGK-1	0.8	0.7	4.6	4.2		182.9	55.1
OGK-2	0.9	0.8	6.5	5.9		212.4	37.2
OGK-3	1.1	0.9	13.0	6.3		198.1	56.1
OGK-4	3.3	2.5	12.6	7.8		711.0	113.7
Enel OGK-5	1.8	1.6	7.6	6.1		457.2	96.6
OGK-6	1.0	0.8	8.9	5.4		195.9	61.2
Harmonic mean	**1.2**	**1.0**	**7.8**	**5.7**		**250.8**	**61.0**

Source: Company data, Bloomberg, Concorde Capital

Current and target* EV/Capacity multiples



** Target capacity multiple is based on Russian harmonic mean multiple adjusted by efficiency premium/(discount) but not adjusted for liquidity discounts. 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 hrs of operation. Figures are provided by NERC for 1 Jan 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 USD * Coal-fired capacity * (1 – hours worked/280,000) +
1,000 USD * Gas-fired capacity * (1 – hours worked/280,000)*(1-75%)

Replacement cost calculation

	Coal-fired units				Gas-fired units			
	Installed capacity, MW	Accumulated depreciation	Adjusted capacity, MW	Replacement costs, USD mln	Installed capacity, MW	Accumulated depreciation	Adjusted capacity, MW	Replacement costs, USD mln
Centrenergo	4,575	92%	377	565	3,000	50%	1,511	378
Dniproenergo	5,785	87%	776	1,163	2,400	49%	1,230	308
Donbasenergo	2,655	93%	180	270	-	-	-	-
Zakhidenergo	4,400	88%	549	824	-	-	-	-

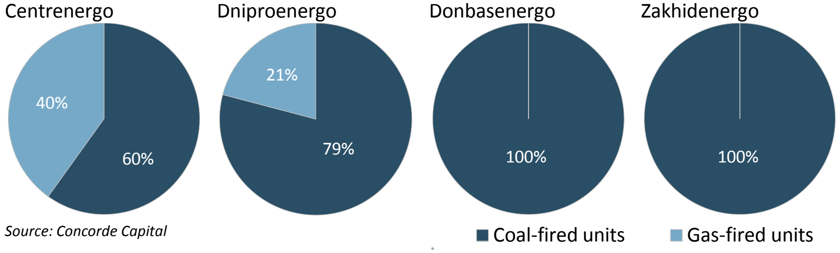
Source: NC ECU, Energobusiness, Company data, Concorde Capital calculations

Replacement cost valuation, USD mln

	Coal-fired units replacement cost	Gas-fired	Implied EV	Implied MCap	# shares, mln	Implied price per share, USD
Centrenergo	565	378	943	858	369.4	2.3
Dniproenergo	1,163	308	1,471	1,367	6.0	229.1
Donbasenergo	270	- -	270	228	23.6	9.7
Zakhidenergo	824	- -	824	751	12.8	58.7

Source: Company data, Concorde Capital calculations

Value breakdown by replacement cost model



Source: Concorde Capital

Sensitivity tables

Key assumptions behind the replacement cost approach is a normative working life of power unit (280,000 hours used) and replacement cost of coal-fired unit of 1,500 USD/kW. We provide sensitivity tables for per share value based on changes in these assumptions.

Centrenergo, USD per share

Replacement cost for coal capacity, $ per kW	Normative working life, ths hours: 260	270	280	290	300
1,300	1.2	1.5	2.0	2.4	2.9
1,400	1.3	1.7	2.2	2.6	3.1
1,500	1.4	1.8	**2.3**	2.8	3.4
1,600	1.5	2.0	2.5	3.1	3.6
1,700	1.6	2.1	2.7	3.3	3.9

Dniproenergo, USD per share

Replacement cost for 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

Source: Concorde Capital

Donbasenergo, USD per share

Replacement cost for coal capacity, $ per kW	Normative working life, ths hours: 260	270	280	290	300
1,300	2.2	4.8	8.1	12.6	16.9
1,400	2.5	5.3	8.9	13.7	18.3
1,500	2.8	5.8	**9.7**	14.8	19.8
1,600	3.1	6.4	10.4	15.9	21.2
1,700	3.4	6.9	11.2	17.0	22.7

Zakhidenergo, USD per share

Replacement cost for 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

Source: Concorde Capital

Company profiles

Centrenergo CEEN

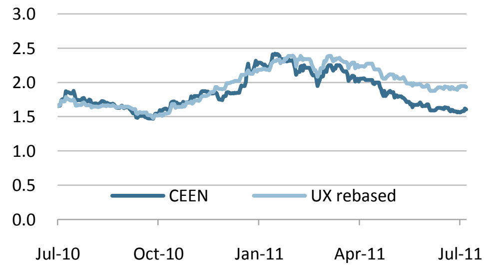
12M target (USD):	**2.6**
Upside:	**61%**

Market Price, USD	1.62
52 Wk H/L USD	2.52/1.39
Chg 3m/6m/52w	-20%/-29%/-13%
Avg M Tr Vol 6M, USD mln	17.5
MCap, USD mln	597.0
Free float	21.7%
FF MCap, USD mln	129.6
No of shares, mln	369.4
Par Value, UAH	1.3

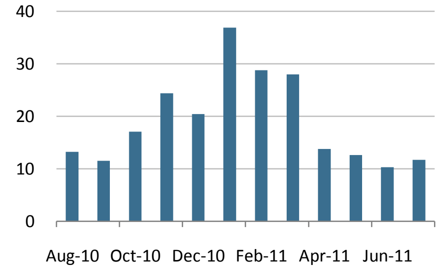
Investment case

- Top line growth at a 28% CAGR over 2010-15E, according to our estimates, driven by capacity utilization growth
- Electricity sector reform, which we expect to start in 2012, after Dniproenergo and Zakhidenergo are privatized, should increase profitability 2x in 2H12-13
- Not on privatization schedule. We believe it will be sold no earlier than 2013, in order for the government to improve regulation and thus the company's margins in order to sell at higher price. Most likely a target for a foreign bidder
- Modernization CapEx demands are in line with local peers. We estimate total CapEx to modernize all power units at USD 856 mln (USD 200 per KW)
- Second most efficient GenCo in Ukraine in terms of quantity of fuel used per kWh of production (399.4 g vs. 399-425 for others) and internal electricity needs (7.3% vs. 7.9%-9.9% for others)
- Most liquid Ukrainian GenCo, with a daily trading volume over the last 12 months of USD 0.87 mln. We estimate Centrenergo's free float at 22%, USD 140 mln. The stock's weight in the UX index basket is 14%

Stock performance, USD per share



Monthly trading volumes, USD mln



Key risks

- Lag in electricity reform could limit the list of potential bidders for the state`s stake and deter foreign players: High
- Privatization delays mean insufficient CapEx to modernize assets at relatively cheap prices for equipment and keep the company from returning to double-digit margins: Medium
- Upside: 3 GW of 7.6 GW of capacity is gas-fired and has been idle for five years due to high gas prices in Ukraine relative to coal. Not accounted for in our valuation, they could be utilized via a tolling scheme by a Russian investor if they privatize the company

Business overview

Operates three power units located in different regions of Ukraine with a total of 7.6 GW (3 GW gas-fired) capacity: Trypillia TPP near Kyiv (installed capacity 1.8 GW, 0.6 GW is gas-fired); Zmiiv TPP near Kharkiv (2.18 GW) and Uglegorsk TPP in Donetsk region (3.6 GW, 2.4 GW is gas-fired). Has the largest share of gas-fired power units among Ukrainian electricity generators (almost 40%). Zmiiv TPP's unit #8 is the only fully reconstructed modern unit among Ukrainian electricity generators; work on unit #2 is underway. In 2010, produced 14.6 TW of electricity (21.6% of total TPP generation and 8.1% of all electricity generation).

Centrenergo financials

Income statement summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Net Revenues	**380.5**	**524.9**	**678.5**	**897.1**	**573.3**	**714.3**	**925.7**	**1,140.4**	**1,387.4**	**1,566.1**	**1,724.1**	**1,837.1**
Change y-o-y	*23.7%*	*37.9%*	*29.3%*	*32.2%*	*-36.1%*	*24.6%*	*29.6%*	*23.2%*	*21.7%*	*12.9%*	*10.1%*	*6.6%*
Gross Profit	62.3	74.3	85.3	59.9	16.3	32.6	56.0	102.1	219.2	246.3	270.2	287.5
Other Operating Income/Costs. net	(17)	5	(8)	(2)	1.5	6.1	1.5	2	2	2	2	2
SG&A	(7.2)	(9.2)	(10.6)	(11.8)	(9.0)	(10.3)	(11.3)	(12.4)	(12.7)	(12.9)	(13.2)	(13.4)
EBITDA	**38.3**	**69.8**	**67.0**	**45.8**	**8.9**	**28.5**	**46.3**	**91.2**	**208.1**	**234.9**	**258.6**	**275.6**
EBITDA margin. %	*10.1%*	*13.3%*	*9.9%*	*5.1%*	*1.6%*	*4.0%*	*5.0%*	*8.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Depreciation	(24.1)	(26.0)	(25.1)	(24.8)	(16.3)	(16.0)	(15.7)	(22.9)	(30.1)	(37.2)	(44.4)	(51.6)
EBIT	**14.1**	**43.9**	**41.9**	**20.9**	**(7.4)**	**12.5**	**30.5**	**68.3**	**178.0**	**197.7**	**214.2**	**224.0**
EBIT margin. %	3.7%	8.4%	6.2%	2.3%	-1.3%	1.8%	3.3%	6.0%	12.8%	12.6%	12.4%	12.2%
Interest Expense	(9.3)	(9.8)	(9.3)	(11.0)	(11.7)	(10.8)	(23.0)	(32.0)	(32.0)	(29.0)	(23.0)	(16.0)
Financial income	-	-	-	0.0	-	0.0	-	-	-			
Other income/(expense)	14.6	(5.9)	(5.6)	(23.6)	(3.1)	3.2	3.7	3.7	3.7	3.7	3.7	3.7
PBT	**19.5**	**28.2**	**27.0**	**(13.6)**	**(22.2)**	**5.0**	**11.3**	**40.1**	**149.8**	**172.4**	**194.9**	**211.7**
Tax	(7.4)	(10.8)	(14.4)	(14.5)	(1.1)	(3.8)	(2.6)	(8.4)	(28.5)	(27.6)	(31.2)	(33.9)
Net Income	**12.1**	**17.3**	**12.6**	**(28.2)**	**(23.3)**	**1.2**	**8.6**	**31.6**	**121.3**	**144.8**	**163.8**	**177.9**
Net Margin. %	*16.5%*	*23.7%*	*21.8%*	*51.4%*	*57.9%*	*56.9%*	*61.5%*	*61.3%*	*8.7%*	*9.2%*	*9.5%*	*9.7%*

Balance sheet summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Current Assets	**374.1**	**362.7**	**375.4**	**137.5**	**119.4**	**152.5**	**197.6**	**243.5**	**296.2**	**334.9**	**369.5**	**395.0**
Cash & Equivalents	2.4	3.2	5.6	3.9	8.4	2.6	3.3	4.1	5.1	6.3	7.7	9.5
Trade Receivables	319.0	298.2	291.4	32.4	26.5	27.7	35.9	44.3	53.8	60.8	66.9	71.3
Inventories	37.4	47.2	55.0	81.0	66.5	99.5	128.9	158.8	193.2	218.1	240.1	255.8
Other current assets	15.3	14.1	23.5	20.2	17.9	22.7	29.5	36.3	44.1	49.8	54.9	58.5
Fixed Assets	**511.9**	**521.2**	**505.7**	**472.4**	**429.3**	**384.4**	**470.4**	**556.4**	**642.4**	**728.4**	**814.4**	**900.4**
PP&E, net	498.8	480.4	467.2	296.1	274.6	273.5	359.5	445.5	531.5	617.5	703.5	789.5
Other Fixed Assets	13.1	40.8	38.5	176.3	154.7	110.9	110.9	110.9	110.9	110.9	110.9	110.9
Total Assets	**886.0**	**883.9**	**881.1**	**609.9**	**548.7**	**536.9**	**668.0**	**799.8**	**938.6**	**1063.3**	**1183.9**	**1295.4**
Shareholders' Equity	**415.9**	**438.6**	**443.6**	**264.0**	**225.0**	**228.3**	**236.9**	**268.6**	**389.9**	**534.7**	**698.5**	**876.3**
Share Capital	95.1	95.1	95.1	62.4	60.1	60.3	60.3	60.3	60.3	60.3	60.3	60.3
Reserves and Other	423.7	424.1	439.9	293.4	284.1	279.0	279.0	279.0	279.0	279.0	279.0	279.0
Retained Earnings	(102.9)	(80.6)	(91.4)	(91.8)	(119.2)	(111.0)	(102.3)	(70.7)	50.6	195.5	359.2	537.1
Current Liabilities	**317.4**	**256.9**	**306.7**	**174.2**	**174.6**	**203.2**	**325.8**	**326.0**	**343.4**	**323.3**	**301.6**	**235.3**
ST Interest Bearing Debt	36.2	46.7	31.1	43.6	41.3	80.4	190.6	178.3	181.4	150.3	118.7	44.5
Trade Payables	198.4	159.2	207.6	54.0	56.1	37.5	48.6	59.9	72.8	82.2	90.5	96.4
Accrued Wages	1.2	1.8	4.3	1.7	1.6	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Accrued Taxes	15.3	15.3	21.6	18.3	13.3	11.6	12.7	14.0	15.4	16.9	18.6	20.5
Other Current Liabilities	66.4	33.9	42.1	56.6	62.3	71.9	71.9	71.9	71.9	71.9	71.9	71.9
LT Liabilities	**152.7**	**188.5**	**130.8**	**170.9**	**149.0**	**105.3**	**105.3**	**205.3**	**205.3**	**205.3**	**183.8**	**183.8**
LT Interest Bearing Debt	72.8	71.9	70.2	58.3	49.2	21.5	21.5	121.5	121.5	121.5	100.0	100.0
Other LT	79.8	116.6	60.6	112.6	99.8	83.8	83.8	83.8	83.8	83.8	83.8	83.8
Total Liabilities & Equity	**886.0**	**883.9**	**881.1**	**609.1**	**548.7**	**536.9**	**668.0**	**799.8**	**938.6**	**1063.3**	**1183.9**	**1295.4**

Dniproenergo DNEN

12M target (USD):	**155**
Upside:	**60%**

Market Price, USD	96.4
52 Wk H/L USD	172/88
Chg 3m/6m/52w	-22%/-42%/-32%
Avg M Tr Vol 6M, USD mln	0.4
MCap, USD mln	575.1
Free float	2.45%
FF MCap, USD mln	14.1
No of shares, mln	5.97
Par Value, UAH	25.0

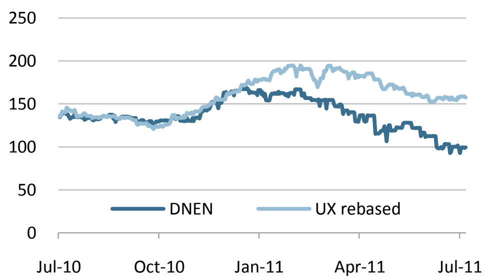
Investment case

- Top line growth at a 28% CAGR over 2010-15E, driven by capacity utilization growth, according to our estimates
- Only GenCo to post a double-digit EBITDA margin in 2010 (10%) thanks to sector-low fuel consumption. We expect the company to remain the most profitable GenCo in the long-term
- Most efficient GenCo in Ukraine in terms of quantity of fuel used per kWh production (382 g vs. 399-425 for others) and internal electricity needs (7.3% vs. 7.9%-9.9% for others)
- Only GenCo capable of accumulating cash in the mid-term in excess of CapEx requirements and of starting to payout dividends (which we estimate at USD 15 per share starting in 2014E)
- Lowest CapEx demands for modernization of any GenCo: we estimate need for all power units at USD 882 mln or 175 USD/kW; its power units are larger scale and thus cheaper to upgrade. 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 Kryvyi Rih TPP (282 MW) and unit #9 of Prydniprovsky TPP (300 MW)
- Illiquid stock, with an average monthly trading volume over last 12M of USD 0.4 mln (we apply a 40% discount for liquidity risk in our valuation). We estimate total free float at USD 14 mln, 2.45%

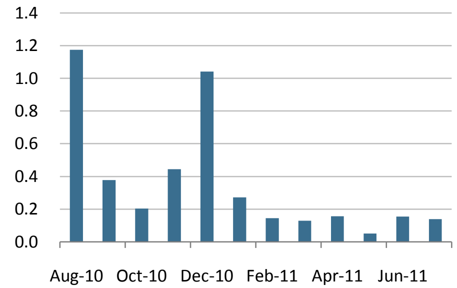
Key risks

- Privatization delays mean insufficient CapEx to modernize assets at relatively cheap prices for equipment and keep the company from returning to double digit margins: Medium

Stock performance, USD per share



Monthly trading volumes, USD mln



Business overview

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). In 2010, produced 15.7 TW of electricity (23.1% of total TPP generation and 8.7% of all electricity generation).

Dniproenergo financials

Income statement summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Net Revenues	**406.9**	**551.2**	**758.0**	**900.7**	**539.8**	**784.9**	**1,149**	**1,526**	**1,964**	**2,269**	**2,731**	**2,938**
Change y-o-y	*24.5%*	*35.5%*	*37.5%*	*18.8%*	*-40.1%*	*45.4%*	*46.4%*	*32.8%*	*28.7%*	*15.5%*	*20.4%*	*7.6%*
Gross Profit	68.0	64.7	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	7	1	(10)	17	5.7	13.2	5.7	6	6	6	6	6
SG&A	(9.1)	(8.8)	(11.2)	(16.1)	(11.1)	(12.9)	(14.2)	(15.7)	(16.0)	(16.3)	(16.6)	(17.0)
EBITDA	**65.8**	**56.6**	**79.6**	**55.6**	**19.4**	**81.2**	**137.9**	**244.1**	**373.1**	**431.1**	**519.0**	**558.2**
EBITDA margin. %	*16.2%*	*10.3%*	*10.5%*	*6.2%*	*3.6%*	*10.4%*	*12.0%*	*16.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*
Depreciation	(37.8)	(37.9)	(36.7)	(36.1)	(24.8)	(26.9)	(34.3)	(41.6)	(48.9)	(56.3)	(63.6)	(70.9)
EBIT	**27.9**	**18.8**	**42.9**	**19.5**	**(5.4)**	**54.3**	**103.6**	**202.5**	**324.1**	**374.8**	**455.3**	**487.3**
EBIT margin. %	*6.9%*	*3.4%*	*5.7%*	*2.2%*	*-1.0%*	*6.9%*	*9.0%*	*13.3%*	*16.5%*	*16.5%*	*16.7%*	*16.6%*
Interest Expense	(2.0)	(3.5)	(9.2)	(10.0)	(12.9)	(14.2)	(24.0)	(23.0)	(12.0)	(4.5)	(5.5)	-
Financial income	0.0	0.0	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Other income/(expense)	(0.3)	2.0	(0.6)	0.5	0.5	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)
PBT	**25.7**	**17.2**	**33.1**	**10.0**	**(17.9)**	**39.3**	**78.9**	**178.8**	**311.4**	**369.5**	**449.1**	**486.5**
Tax	(21.1)	(14.7)	(9.0)	(9.6)	-	(15.5)	(18.5)	(37.5)	(59.2)	(59.1)	(71.9)	(77.8)
Net Income	**4.6**	**2.5**	**24.1**	**0.4**	**(17.9)**	**23.8**	**60.3**	**141.2**	**252.2**	**310.4**	**377.2**	**408.7**
Net Margin. %	*1.1%*	*0.5%*	*3.2%*	*0.0%*	*-3.3%*	*3.0%*	*5.3%*	*9.3%*	*12.8%*	*13.7%*	*13.8%*	*13.9%*

Balance sheet summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Current Assets	**193.9**	**75.8**	**125.3**	**150.1**	**144.5**	**198.0**	**282.8**	**375.5**	**483.3**	**658.4**	**892.6**	**1,160.1**
Cash & Equivalents	9.4	2.7	11.9	8.5	10.5	7.9	11.6	15.4	19.8	122.8	247.9	466.6
Trade Receivables	117.6	18.6	21.3	27.6	42.8	56.8	83.2	110.5	142.2	164.2	197.7	212.7
Inventories	45.5	43.5	69.7	85.0	61.0	84.7	124.0	164.6	211.9	244.8	294.7	317.0
Other current assets	21.4	11.0	22.3	29.0	30.2	48.6	64.0	85.0	109.4	126.5	152.2	163.8
Fixed Assets	**355.2**	**357.5**	**365.1**	**292.2**	**280.0**	**325.7**	**420.6**	**508.6**	**596.6**	**684.6**	**772.6**	**860.6**
PP&E, net	308.3	319.5	319.3	249.7	231.5	227.3	315.3	403.3	491.3	579.3	667.3	755.3
Other Fixed Assets	46.9	38.0	45.8	42.5	48.5	98.4	105.3	105.3	105.3	105.3	105.3	105.3
Total Assets	**549.1**	**433.3**	**490.3**	**442.3**	**424.5**	**523.7**	**703.4**	**884.1**	**1,079.9**	**1,343.0**	**1,665.2**	**2,020.8**
Shareholders' Equity	**68.8**	**83.5**	**336.1**	**269.2**	**233.1**	**269.7**	**330.0**	**471.2**	**723.5**	**1,033.9**	**1,411.1**	**1,819.8**
Share Capital	19.4	19.4	227.7	149.4	18.7	18.7	18.7	18.7	18.7	18.7	18.7	18.7
Reserves and Other	431.5	436.0	453.1	337.0	466.6	482.5	482.5	482.5	482.5	482.5	482.5	482.5
Retained Earnings	(382.1)	(371.9)	(344.7)	(217.1)	(252.2)	(231.5)	-171.2	-30.0	222.2	532.7	909.9	1,318.6
Current Liabilities	**442.9**	**304.2**	**153.5**	**169.7**	**178.3**	**244.3**	**363.6**	**403.1**	**356.4**	**309.1**	**254.1**	**201.0**
ST Interest Bearing Debt	52.0	56.4	38.7	64.9	58.9	89.4	181.0	191.7	111.6	40.3	-50.3	-120.8
Trade Payables	256.2	152.0	31.0	36.9	45.3	56.4	82.6	109.7	141.2	163.1	196.4	211.3
Accrued Wages	1.4	1.9	2.3	2.1	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Accrued Taxes	75.1	41.7	11.8	10.9	9.9	15.6	17.2	18.9	20.8	22.9	25.2	27.7
Other Current Liabilities	58.2	52.2	69.8	54.9	62.1	80.6	80.6	80.6	80.6	80.6	80.6	80.6
LT Liabilities	**37.4**	**45.6**	**0.7**	**0.5**	**13.1**	**9.8**	**9.8**	**9.8**	**0.0**	**0.0**	**0.0**	**0.0**
LT Interest Bearing Debt	14.9	13.8	-	-	13.1	9.8	9.8	9.8	0.0	0.0	0.0	0.0
Other LT	22.5	31.8	0.7	0.5	-	-	0.0	0.0	0.0	0.0	0.0	0.0
Total Liabilities & Equity	**549.1**	**433.3**	**490.3**	**439.4**	**424.5**	**523.7**	**703.4**	**884.1**	**1,079.9**	**1,343.0**	**1,665.2**	**2,020.8**

Donbasenergo CEEN

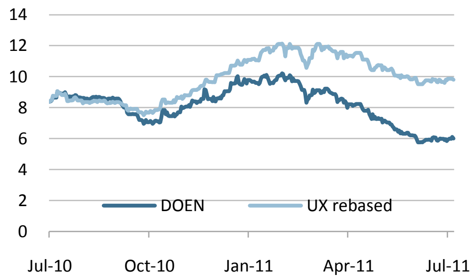
12M target (USD):	**14.5**
Upside:	**145%**

Market Price, USD	5.9
52 Wk H/L USD	10.5/5.7
Chg 3m/6m/52w	-27%/-38%/-34%
Avg M Tr Vol 6M, USD mln	5.4
MCap, USD mln	139.8
Free float	14.2%
FF MCap, USD mln	19.9
No of shares, mln	23.6
Par Value, UAH	10

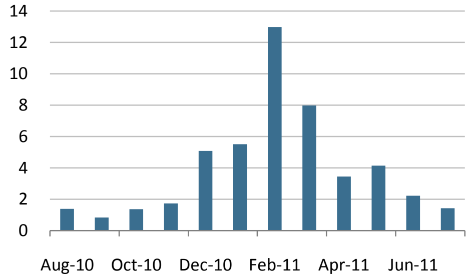
Investment case

- Top line growth at a 18% CAGR over 2010-15E, according to our estimates, the lowest growth among GenCos due to its high capacity utilization and low fuel efficiency, which will limit growth
- Due to low fuel efficiency and inefficient government management, Donbasenergo remains the least profitable GenCo, posting a net losses for nine consecutive quarters. We expect Donbasenergo to remain the least profitable in the mid-term
- Least efficient GenCo in terms of quantity of fuel used per kWh production (424.5 g vs. 399-425 for other) and internal electricity needs (7.3% vs. 7.9%-9.9% for others)
- Not on privatization schedule. We believe it will be sold no earlier than 2013, in order for the government to improve regulation and thus the company's margins in order to sell at higher price. Most likely a target for a foreign bidder
- Located in close proximity to coal mines, which allows for 7-9% cheaper coal supplies than to Dniproenergo and Zakhidenergo
- We estimate CapEx needs as the highest per unit of capacity (USD 269 per kW) because the company operates small-sized units, which are more expensive to modernize. We estimate total CapEx needs at USD 647 mln
- Second most-liquid GenCo, with average monthly trading volumes of USD 5.4 mln over the last 12 months. We estimate Donbasenergo`s free float at 14%, USD 20 mln

Stock performance, USD per share



Trading volumes, USD mln



Key risks

- Lag in electricity reform could limit the list of potential bidders for the state`s stake and deter foreign players: High
- Privatization delays mean insufficient CapEx to modernize assets at relatively cheap prices for equipment and keep the company from returning to double digit margins: Medium

Business overview

Smallest thermal generation company - operates two power units located in Donetsk region: Starobeshev TPP (installed capacity 1.78 GW) and Slaviansk TPP (0.88 GW, a single working power unit). Total capacity: 2.7 GW, 100% gas-fired. Launched reconstructed power unit #4 at Starobeshev – this is the first unit in Ukraine to use CFB technology and burn low quality coal and coal refuse. Produced 8.1 TWh of electricity in 2010 (11.9% of total TPP generation and 4.5% of all electricity generation).

Donbasenergo financials

Income statement summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Net Revenues	**223.7**	**272.0**	**290.9**	**419.0**	**331.0**	**382.3**	**481.7**	**577.3**	**692.2**	**777.1**	**870.8**	**932.3**
Change y-o-y	*32.0%*	*21.6%*	*6.9%*	*44.1%*	*-21.0%*	*15.5%*	*26.0%*	*19.8%*	*19.9%*	*12.3%*	*12.1%*	*7.1%*
Gross Profit	52.8	46.5	36.1	55.3	10.6	9.5	16.7	42.0	68.8	91.4	109.8	116.8
Other Operating Income/Costs. net	(5)	(9)	7	2	11.5	0.4	0.4	0	0	0	0	0
SG&A	(7.3)	(8.3)	(10.7)	(12.8)	(9.6)	(11.2)	(12.3)	(13.6)	(13.8)	(14.1)	(14.4)	(14.7)
EBITDA	**40.7**	**28.9**	**32.7**	**44.6**	**12.5**	**(1.3)**	**4.8**	**28.9**	**55.4**	**77.7**	**95.8**	**102.6**
EBITDA margin. %	*18.2%*	*10.6%*	*11.3%*	*10.6%*	*3.8%*	*-0.3%*	*1.0%*	*5.0%*	*8.0%*	*10.0%*	*11.0%*	*11.0%*
Depreciation	(15.9)	(14.2)	(12.6)	(12.6)	(9.2)	(9.5)	(9.5)	(14.8)	(20.2)	(25.5)	(30.8)	(36.2)
EBIT	**24.8**	**14.7**	**20.1**	**32.0**	**3.3**	**(10.8)**	**(4.7)**	**14.0**	**35.2**	**52.2**	**64.9**	**66.4**
EBIT margin. %	*11.1%*	*5.4%*	*6.9%*	*7.6%*	*1.0%*	*-2.8%*	*-1.0%*	*2.4%*	*5.1%*	*6.7%*	*7.5%*	*7.1%*
Interest Expense	(4.9)	(5.8)	(5.6)	(6.7)	(6.4)	(6.3)	(14.0)	(25.0)	(32.0)	(42.0)	(51.0)	(56.0)
Financial income	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other income/(expense)	5.6	(3.8)	(1.0)	(11.4)	(1.3)	0.6	0.6	0.6	0.6	0.6	0.6	0.6
PBT	**25.5**	**5.1**	**13.4**	**13.9**	**(4.4)**	**(16.4)**	**(18.1)**	**(10.4)**	**3.8**	**10.8**	**14.6**	**11.0**
Tax	(14.4)	(5.8)	(8.2)	(8.9)	-	-	4.2	-	-	-	-	(1.8)
Net Income	**11.1**	**(0.8)**	**5.3**	**5.0**	**(4.4)**	**(16.4)**	**(13.8)**	**(10.4)**	**3.8**	**10.8**	**14.6**	**9.2**
Net Margin. %	*5.0%*	*-0.3%*	*1.8%*	*1.2%*	*-1.3%*	*-4.3%*	*-2.9%*	*-1.8%*	*0.6%*	*1.4%*	*1.7%*	*1.0%*

Balance sheet summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Current Assets	**204.7**	**186.1**	**167.1**	**147.2**	**170.3**	**130.6**	**164.6**	**197.2**	**236.5**	**265.5**	**297.5**	**318.5**
Cash & Equivalents	11.9	15.2	4.6	8.0	10.7	6.9	8.6	10.4	12.4	13.9	15.6	16.7
Trade Receivables	139.6	134.7	122.8	88.4	71.5	57.8	72.9	87.3	104.7	117.5	131.7	141.0
Inventories	32.0	28.5	28.5	39.8	68.6	39.2	49.4	59.2	70.9	79.6	89.2	95.5
Other current assets	21.2	7.7	11.3	11.0	19.6	26.7	33.7	40.4	48.4	54.3	60.9	65.2
Fixed Assets	**318.4**	**312.5**	**313.3**	**196.6**	**183.4**	**200.8**	**218.1**	**282.1**	**346.1**	**410.1**	**474.1**	**538.1**
PP&E, net	204.9	196.7	199.8	120.7	106.0	111.4	116.7	180.7	244.7	308.7	372.7	436.7
Other Fixed Assets	113.5	115.8	113.6	75.8	77.4	89.4	101.4	101.4	101.4	101.4	101.4	101.4
Total Assets	**523.1**	**498.6**	**480.4**	**343.8**	**353.7**	**331.4**	**382.7**	**479.3**	**582.6**	**675.6**	**771.6**	**856.6**
Shareholders' Equity	**172.1**	**165.7**	**187.5**	**118.6**	**105.8**	**86.3**	**72.5**	**62.1**	**65.9**	**76.7**	**91.3**	**100.5**
Share Capital	46.8	46.8	46.8	30.7	29.6	29.7	29.7	29.7	29.7	29.7	29.7	29.7
Reserves and Other	227.5	226.2	230.6	139.2	130.5	107.2	107.2	107.2	107.2	107.2	107.2	107.2
Retained Earnings	(102.2)	(107.3)	(89.9)	(51.3)	(54.3)	(50.6)	(64.4)	(74.8)	(71.0)	(60.2)	(45.6)	(36.4)
Current Liabilities	**182.4**	**179.2**	**166.7**	**129.0**	**163.5**	**168.9**	**234.0**	**244.5**	**344.0**	**326.2**	**407.6**	**483.4**
ST Interest Bearing Debt	37.9	59.7	57.2	48.7	44.9	47.5	107.5	112.8	206.1	183.5	259.6	331.5
Trade Payables	41.1	13.3	17.7	12.2	44.4	18.0	22.7	27.2	32.6	36.6	41.0	43.9
Accrued Wages	1.0	1.2	1.4	1.1	1.1	1.3	1.3	1.5	1.6	1.8	1.9	2.1
Accrued Taxes	9.8	8.7	6.7	13.4	7.2	5.0	5.5	6.0	6.6	7.3	8.0	8.8
Other Current Liabilities	92.7	96.3	83.7	53.6	65.9	97.1	97.1	97.1	97.1	97.1	97.1	97.1
LT Liabilities	**168.6**	**153.7**	**126.2**	**73.5**	**84.4**	**76.2**	**76.2**	**172.7**	**172.7**	**272.7**	**272.7**	**272.7**
LT Interest Bearing Debt	49.5	39.3	13.7	7.0	5.2	3.5	3.5	100.0	100.0	200.0	200.0	200.0
Other LT	119.1	114.4	112.6	66.5	79.2	72.7	72.7	72.7	72.7	72.7	72.7	72.7
Total Liabilities & Equity	**523.1**	**498.6**	**480.4**	**321.2**	**353.7**	**331.4**	**382.7**	**479.3**	**582.6**	**675.6**	**771.6**	**856.6**

Zakhidenergo ZAEN

12M target (USD):	**47**
Upside:	**20%**

Market Price, USD	39.2
52 Wk H/L USD	71.6/37.4
Chg 3m/6m/52w	-11%/-29%/-44%
Avg M Tr Vol 6M, USD mln	1.4
MCap, USD mln	501.1
Free float	4.0%
FF Mcap, USD mln	20.0
No of shares, mln	12.7
Par Value, UAH	10

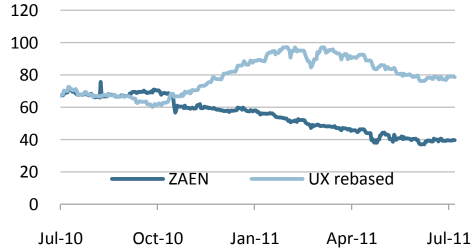
Investment case

- Top line growth at a 21% CAGR in 2010-15, according to our projections, thanks to a low base in 2010 and capacity utilization increase. We expect revenue in 2011 of USD 832 mln (up 32% y-o-y) and EBITDA of USD 33.3 mln (up 3x y-o-y).
- We estimate Zakhidenergo's CapEx needs for modernization at USD 1,071 mln over the next 10 years to upgrade its power units, the highest absolute figure among all GenCos (USD 254 per kW, second highest after Donbasenergo)
- EBITDA margins have been within 3% of zero the last three years, barely breaking even on EBITDA and posting net losses. We see several deterrents 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
- Despite being the only GenCo connected to the EU electricity grid, 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 domestically
- Remains a component of both the UX and PFTS indices, but 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 our valuation)

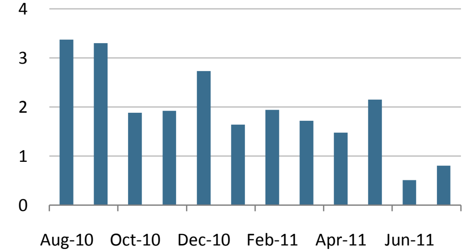
Key risks

- Privatization delays mean insufficient CapEx to modernize assets at relatively cheap prices for equipment and keep the company from returning to double digit margins: Medium

Stock performance, USD per share



Trading volumes, USD mln



Business overview

Operates three 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). Burshtyn 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 Burshtyn TPP. Dobrotvir TPP is located near the Polish border and can work for the Polish energy system. In 2010, produced 11.3 TW of electricity (16.7% of total TPP generation and 6.3% of all electricity generation).

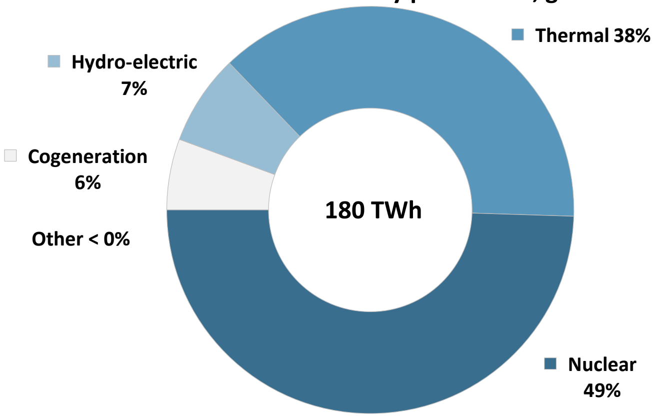
Zakhidenergo financials

Income statement summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Net Revenues	**480.2**	**617.0**	**715.8**	**923.4**	**573.9**	**630.4**	**832.2**	**1,075.5**	**1,322.7**	**1,470.6**	**1,647.8**	**1,764.2**
Change y-o-y	*30.8%*	*28.5%*	*16.0%*	*29.0%*	*-37.8%*	*9.8%*	*32.0%*	*29.2%*	*23.0%*	*11.2%*	*12.1%*	*7.1%*
Gross Profit	43.5	70.2	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	(8)	(13)	(13)	(15)	(6.4)	(19.0)	(6.4)	(6)	(6)	(6)	(6)	(6)
SG&A	(12.1)	(14.7)	(14.9)	(17.8)	(12.8)	(14.4)	(15.9)	(17.5)	(17.8)	(18.2)	(18.6)	(18.9)
EBITDA	**23.1**	**43.0**	**45.9**	**26.1**	**(7.0)**	**11.0**	**33.3**	**75.3**	**105.8**	**161.8**	**197.7**	**229.3**
EBITDA margin. %	*4.8%*	*7.0%*	*6.4%*	*2.8%*	*-1.2%*	*1.7%*	*4.0%*	*7.0%*	*8.0%*	*11.0%*	*12.0%*	*13.0%*
Depreciation	(12.2)	(12.6)	(10.9)	(14.1)	(12.3)	(12.6)	(12.6)	(21.5)	(30.4)	(39.3)	(48.3)	(57.2)
EBIT	**10.9**	**30.4**	**35.0**	**12.0**	**(19.3)**	**(1.6)**	**20.7**	**53.8**	**75.4**	**122.4**	**149.5**	**172.2**
EBIT margin. %	*2.3%*	*4.9%*	*4.9%*	*1.3%*	*-3.4%*	*-0.3%*	*2.5%*	*5.0%*	*5.7%*	*8.3%*	*9.1%*	*9.8%*
Interest Expense	(5.0)	(10.5)	(16.1)	(17.6)	(14.9)	(13.1)	(12.0)	(24.0)	(32.0)	(36.0)	(39.0)	(40.0)
Financial income	0.0	0.1	(0.0)	0.0	-	-	-	-	-	-	-	-
Other income/(expense)	0.8	0.7	0.8	(4.2)	0.5	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
PBT	**6.7**	**20.7**	**19.7**	**(9.7)**	**(33.6)**	**(14.9)**	**8.5**	**29.6**	**43.2**	**86.2**	**110.3**	**132.0**
Tax	(2.6)	(16.2)	(9.9)	(6.0)	-	(8.6)	(2.0)	(6.2)	(8.2)	(13.8)	(17.6)	(21.1)
Net Income	**4.1**	**4.5**	**9.9**	**(15.7)**	**(33.6)**	**(23.5)**	**6.5**	**23.4**	**35.0**	**72.4**	**92.6**	**110.9**
Net Margin. %	0.8%	0.7%	1.4%	-1.7%	-5.9%	-3.7%	0.8%	2.2%	2.6%	4.9%	5.6%	6.3%

Balance sheet summary, USD mln	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Current Assets	**201.7**	**199.9**	**195.8**	**172.1**	**132.7**	**150.9**	**199.2**	**257.4**	**316.6**	**351.9**	**394.4**	**422.2**
Cash & Equivalents	1.3	1.0	0.2	0.5	4.9	5.7	7.6	9.8	12.0	13.4	15.0	16.1
Trade Receivables	128.9	113.4	114.7	82.3	48.6	38.2	50.4	65.1	80.1	89.1	99.8	106.9
Inventories	43.2	53.9	46.3	56.0	44.5	50.5	66.6	86.1	105.9	117.8	132.0	141.3
Other current assets	28.4	31.6	34.6	33.3	34.7	56.5	74.5	96.3	118.5	131.7	147.6	158.0
Fixed Assets	**307.6**	**319.1**	**335.0**	**240.2**	**242.8**	**247.0**	**262.0**	**369.0**	**476.0**	**583.0**	**690.0**	**797.0**
PP&E, net	249.2	253.9	272.7	180.4	176.2	180.2	195.2	302.2	409.2	516.2	623.2	730.2
Other Fixed Assets	58.5	65.1	62.3	59.9	66.6	66.8	66.8	66.8	66.8	66.8	66.8	66.8
Total Assets	**509.4**	**519.0**	**530.8**	**412.3**	**375.5**	**397.8**	**461.1**	**626.4**	**792.5**	**934.9**	**1084.3**	**1219.2**
Shareholders' Equity	**275.2**	**279.3**	**284.2**	**170.7**	**115.8**	**63.7**	**70.2**	**93.6**	**128.6**	**201.0**	**293.6**	**404.5**
Share Capital	25.3	25.3	25.3	16.6	16.0	16.1	16.1	16.1	16.1	16.1	16.1	16.1
Reserves and Other	310.3	315.6	323.2	219.6	210.9	184.5	184.5	184.5	184.5	184.5	184.5	184.5
Retained Earnings	(60.4)	(61.6)	(64.3)	(65.5)	(111.1)	(136.9)	(130.4)	(107.0)	(72.0)	0.4	93.0	203.9
Current Liabilities	**147.0**	**188.7**	**207.7**	**222.7**	**237.0**	**310.0**	**366.8**	**411.1**	**442.3**	**512.3**	**569.0**	**593.0**
ST Interest Bearing Debt	53.0	97.3	123.3	81.4	74.6	52.6	79.8	88.7	83.6	130.6	160.1	164.8
Trade Payables	44.7	40.6	42.4	32.1	80.2	85.7	113.1	146.2	179.8	199.9	224.0	239.9
Accrued Wages	2.6	3.3	2.7	2.1	1.6	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Accrued Taxes	15.7	18.4	4.1	21.1	4.3	21.6	23.8	26.2	28.8	31.7	34.9	38.3
Other Current Liabilities	31.0	29.2	35.2	86.1	76.3	147.7	147.7	147.7	147.7	147.7	147.7	147.7
LT Liabilities	**87.1**	**50.9**	**38.9**	**18.5**	**22.7**	**24.1**	**24.1**	**121.7**	**221.7**	**221.7**	**221.7**	**221.7**
LT Interest Bearing Debt	9.4	8.4	7.4	4.9	10.6	2.4	2.4	100.0	200.0	200.0	200.0	200.0
Other LT	77.7	42.5	31.5	13.6	12.2	21.7	21.7	21.7	21.7	21.7	21.7	21.7
Total Liabilities & Equity	**509.4**	**519.0**	**530.8**	**411.9**	**375.5**	**397.8**	**461.1**	**626.4**	**792.5**	**934.9**	**1084.3**	**1219.2**

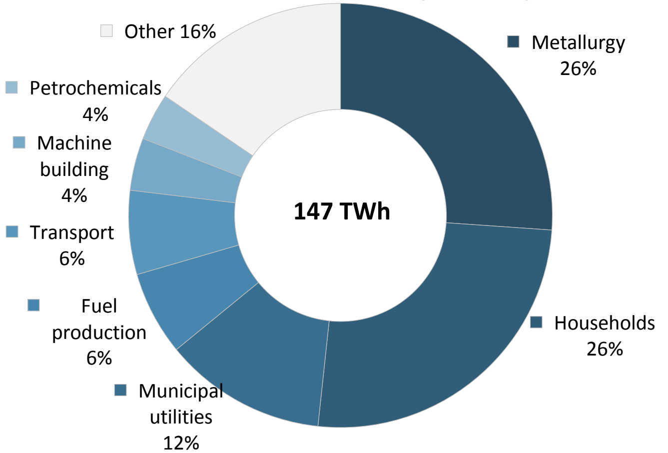
Appendix: Electricity market snapshot

Breakdown of Ukraine's 2010 electricity production, gross



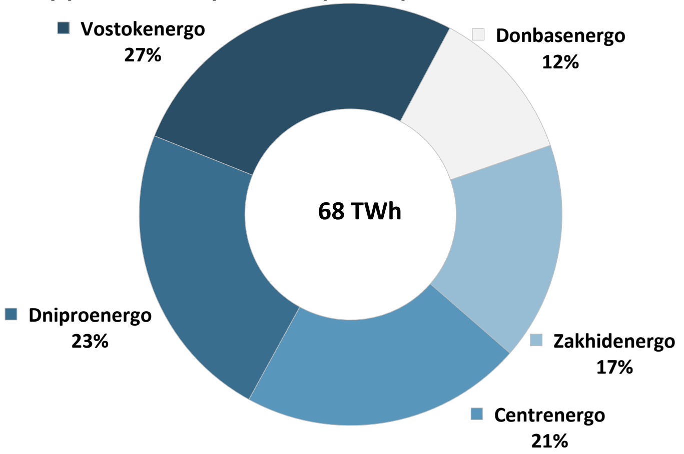
Source: Energobusiness

Breakdown of Ukraine's 2010 electricity consumption, net



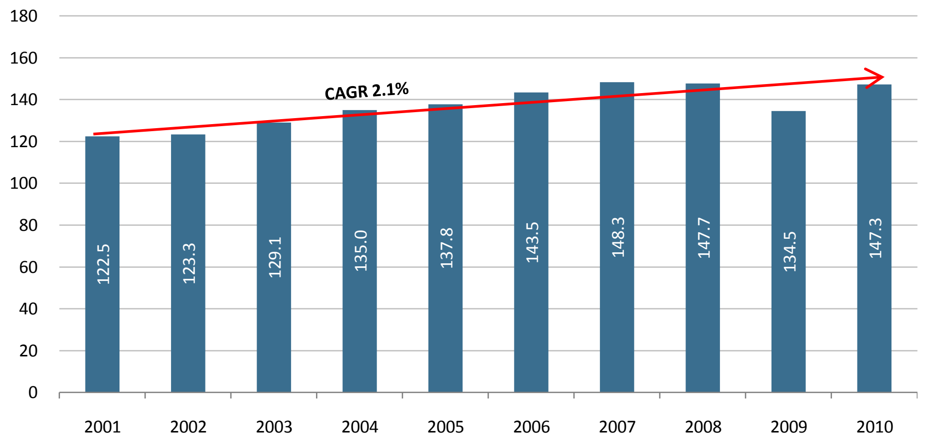
Source: Energobusiness

Electricity production by thermal power plants, 2010



Source: Energobusiness

Ukraine's electricity consumption dynamics, TWh, net



Source: Ministry of Fuel and Coal Industry

Analyst certification

We, Yegor Samusenko and Antonina Davydenko, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

GenCos rating history

	CEEN price, USD		DNEN price, USD		DOEN price, USD		ZAEN price, USD	
	Closing	Target	Closing	Target	Closing	Target	Closing	Target
13-May-05	0.8	0.8	75	88	4.2	6.8	27.7	29
30-May-05							27.7	30.5
4-Jul-05					4.4	6		
19-Jul-05							24	30.5
26-Sep-05	0.8	0.8	67	99	4.2	6.6	26	34
3-Jan-06	0.5	0.8						
26-Jun-06	0.8	0.9	76	123	5.2	7.4	26.5	34
25-Sep-06							32	34
26-Sep-06					7.2	7.4		
15-Nov-06	1.2	1.1	109	131	7.8	9.6	40	35.4
28-Nov-06	1.2	1.1	109	131	8	9.6	41	35.4
22-Dec-06	1.4	1.4	126	134	8.7	11.3	52.8	41.2
21-Mar-07	2.8	3.2	288	383	17.1	27.6	73.4	94.3
2-Apr-07	3.3	3.2	347	383	21.4	27.6	88.1	94.3
22-Jun-07			400	432				
23-Jul-07			366	432				
31-Aug-07			373	410				
10-Sep-07	4.1	4.2	383	410	27.6	27.6	103.8	94.3
10-Oct-07	5.0	5.4	512	516	32.3	43.2	121.7	130.4
24-Mar-08			424	516				
10-Apr-08			430	516				
28-May-08	4.0	5.2	417	580	23.6	40	89.1	125
27-Jun-08			385	460				
24-Nov-08	0.8	3.2	69	260	4.0	19.3	51.5	88
26-Nov-08	0.8	3.2	70	266	4.0	19.3	53.0	88
03-Feb-09	0.6	3.5	62	284	3.1	22.6	45.7	96.6
24-Mar-09			53	284				
08-Apr-10	2.2	3.2	183	326	12.4	27.0	56.9	86.7
19-Aug-10			133	200				
06-Sep-10	1.7	2.8	136	200	8.7	22.7	66.8	74.3
05-Nov-10	1.7	2.6	130	200	7.2	17.8	66.8	66.9
13-Dec-10	1.8	2.6	151	200	8.9	18.4	59.0	68.8
02-Aug-11	1.6	2.6	96	155	5.9	14.5	39.2	47

** In July 2009, Yegor Samusenko took over coverage; prior to that point, it was covered by other Concorde analysts.*

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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