



CONCORDE CAPITAL

Ukraine / Electricity

# Kyivenergo

## AGM: Staying the Course

April 13, 2007

Upside 2%

### HOLD

12M Target: USD 4.0

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Shareholders at Kyivenergo's AGM approved encouraging 2006 financial results and decided to direct 16.6% of net income to a dividend payout. Additionally, the election of a new supervisory board saw the NC ECU's influence on operating control decreasing. Management again expressed optimism about the prolongation of Kyivenergo's lease of the Kyiv assets, though the ultimate fate is still uncertain. We retain our target price and recommendation for KIEN. HOLD.

Bloomberg	KIEN.UZ
Reuters	KIEN.PFT
'DRs	Absent

Market data	
<b>Market price, USD</b>	<b>3.9</b>
52 wk H / L	5.1 / 1.0

<b>Shares, mln</b>	<b>108.36</b>
<b>MCap, USD mln</b>	<b>422.6</b>

Free float, %	9%
Free float, USD mln	38.0

Ownership	
State (NC ECU)	50.0%
Kyiv city	12.7%
Khmelnitskiy group	27.0%
Other	10.3%

### Financial improvements result of revaluation

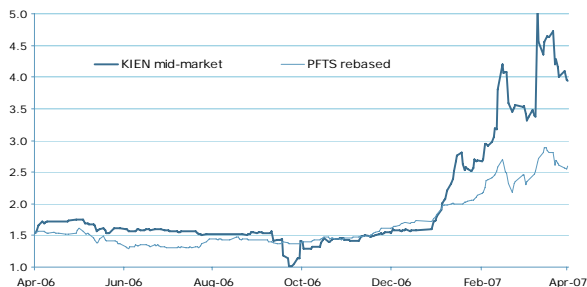
Kyivenergo reported strong 2006 financial results: revenue grew 71% yoy (to USD 650 mln); EBITDA rose 36% yoy (USD 38 mln); and net income jumped up 106% yoy (USD 3.9 mln).

Kyivenergo's profitability growth is mainly due to re-stating receivables. The company decreased its allowance for bad receivables by USD 39.2 mln, which automatically resulted in an operating income increase by the same amount. Without this restatement, EBITDA would be USD -1.1 mln.

We believe the management's restatement was right on the money: the company had a reason to decrease their allowances, as chances that more payables will be paid back are higher now after it took advantage of the law on debt reconciliation.

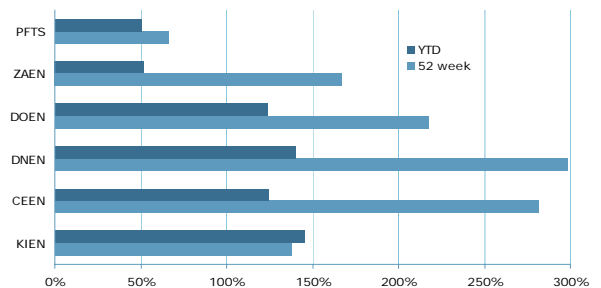
We do not see any risk of Kyivenergo reporting negative EBITDA in the future, as the company's main problem - extremely low heating tariffs was solved in late 2006 - early 2007.

### Trading history, USD



Source: PFTS

### Relative performance



### Key financials, USD mln

	Revenue		EBITDA		Net Income	
	new	old est	new	old est	new	old est
<b>2006</b>	650	655	38	26	4	1
<b>2007E</b>	926	1,025	71	104	31	58

Source: Kyivenergo, Concorde Capital forecasts

### Market ratios

	EV/S	EV/EBITDA	P/E
<b>2006</b>	0.84	14.3	115.4
<b>2007E</b>	0.59	7.9	13.6

## 2007 Forecasts downgraded on modest operating results

### 2006 Profitability by segment

	Total	Electricity segment		Heat segment	Other
		Generation	Distribution		
Sales, USD mln	650	179	300	165	6
Gross margin	-4%	34%	-3%	-47%	-7%
Operating margin	2%	31%	-6%	-13%	-19%

Source: Kyivenergo

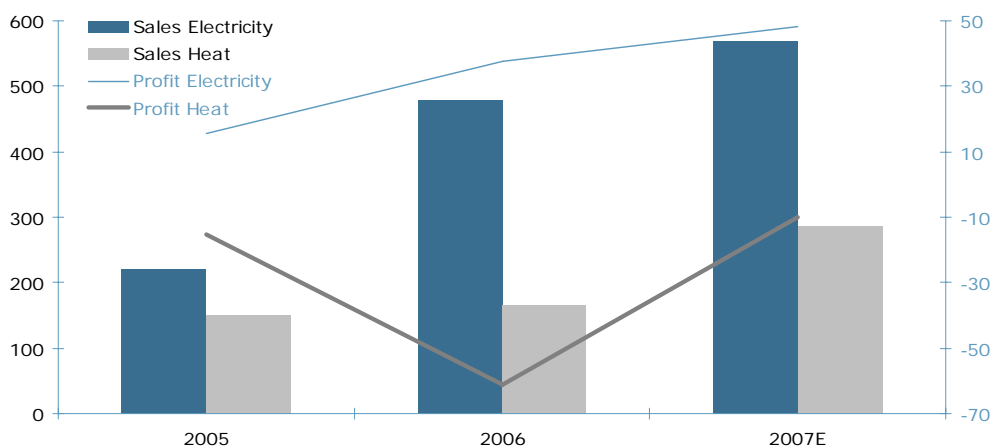
In 2006 Kyivenergo increased the profitability of its electricity segment by 0.9 pp yoy, mainly due to cutting down on electricity losses in its power grid. The company's power generating segment was affected by a significant rise in both the selling price of electricity and the price of inputs (gas), which left profitability almost constant in 2006. Excess losses in distribution grid remained high (3.4%) and were the main reason for the distribution segment's negative margins. In general, Kyivenergo's electricity segment profits are lower than we forecasted.

We expect Kyivenergo to increase its electricity segment profitability by about 0.6 pp in 2007 due to a further decrease in electricity losses.

Kyivenergo's heat segment was a loss-maker in 2006, just as we expected, due to low heating tariffs that did not cover heat production costs. With an increase in the average heating tariff by 72% in 2007, the estimated profitability of the heat segment will increase from a negative margin of 54% in 2006 (not adjusted by other operating income) to negative 3.5% in 2007.

Kyivenergo is now lobbying for another increase in heating tariffs, and the city of Kyiv might compensate the difference between costs and tariffs, so that in 2007 Kyivenergo's heat segment could reach its breakeven point. Though, we conservatively forecast no changes in heat tariffs for 2007.

### Performance by segment, USD mln



Source: Kyivenergo, Concorde Capital forecast

As we reduce our expectations on Kyivenergo's electricity production and heat tariffs, we also downgrade our 2007 forecasts for Kyivenergo's net revenue to USD 920 mln and net income to USD 31 mln. We do not revise our target price based on changed forecasts, as we previously set our target below our DCF implied price.

### **The NC ECU loses operating control?**

At the AGM yesterday, shareholders elected a new supervisory board. Representatives of controlling shareholder, the National Energy Company (NC ECU), obtained only three places out of seven. It historically had four posts, which means it has only 43% of representation on the supervisory board, even though it controls 51% of shares.

Taken along with changes to the Kyivenergo's charter that were also approved, which delegated power to dismiss the CEO and company directors from the shareholders to the supervisory board, the NC ECU looks to have lost operating control over Kyivenergo.

The other four representatives of the supervisory board are two delegates of offshore companies controlled by the Khemlitskiy/Ivanov group, one representative of Kyivenergoholding (a holding company close to Khmel'nitskiy) and one representative from the Kyiv city council (in fact, the Kyiv mayor himself), which traditionally is elected the head of the board. The new breakdown is interesting (the NC ECU – 3, Khmel'nitskiy group – 3, and Kyiv city - 1) with the deciding vote in the hands of the Kyiv City Council representative.

In any case, we see the changes in the supervisory board as positive for Kyivenergo: now the city of Kyiv and businessmen close to them have operating control over the company, and therefore Kyiv might forget about its attempts to stop its lease agreement with Kyivenergo.

### **Dividends**

The NC ECU's general policy for dividend payouts this year was 15% of net income and it got a similar decision approved for KIEN, the only difference was that dividend amount was adjusted to pay exactly UAH 0.03 (USD 0.006) per share, which is a 16.6% payout ratio (dividend yield is 0.15%). Only the NC ECU voted for this decision, but its votes were enough to get it approved; minority shareholders had insisted on a 40% dividend payout. The ex-dividend date is April 13.

### **Recommendation**

We do not change our target price for KIEN and support our HOLD recommendation. We are looking forward to any news on Kyivenergo's lease to be prolonged after May 1, 2007.

**Financial statement summary (Ukrainian accounting standards)**
**Income Statement Summary, USD mln**

	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Net Revenues</b>	<b>309.6</b>	<b>376.5</b>	<b>650.3</b>
Cost Of Sales	(227.5)	(311.8)	(653.2)
Gross Profit	82.1	64.7	(3.0)
Other Operating Income/Costs, net	(40.7)	(9.6)	51.2
SG&A	(22.2)	(27.4)	(10.2)
<b>EBITDA</b>	<b>19.2</b>	<b>27.7</b>	<b>38.1</b>
<i>EBITDA margin, %</i>	6%	7%	6%
Depreciation	(16.4)	(20.8)	(23.4)
<b>EBIT</b>	<b>2.7</b>	<b>6.9</b>	<b>14.7</b>
<i>EBIT margin, %</i>	1%	2%	2%
Interest Expense	(1.8)	(3.4)	(7.0)
Financial income/(expense)	0.1	0.1	-
Other income/(expense)	0.5	5.5	4.2
<b>PBT</b>	<b>1.6</b>	<b>9.1</b>	<b>11.9</b>
Tax	(0.4)	(7.2)	(8.2)
<i>Effective tax rate</i>	23%	80%	69%
<b>Net Income</b>	<b>1.2</b>	<b>1.9</b>	<b>3.7</b>
<i>Net Margin, %</i>	0.4%	0.5%	0.6%

**Balance Sheet Summary, USD mln**

	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Current Assets</b>	<b>111.1</b>	<b>135.5</b>	<b>158.0</b>
Cash & Equivalents	4.3	7.1	3.7
Trade Receivables	41.9	37.3	72.4
Inventories	49.4	73.3	77.6
Other current assets	15.4	17.8	4.2
<b>Fixed Assets</b>	<b>335.0</b>	<b>371.3</b>	<b>423.5</b>
PP&E, net	233.1	269.8	301.3
Other Fixed Assets	101.9	101.4	122.2
<b>Total Assets</b>	<b>446.1</b>	<b>506.8</b>	<b>581.5</b>
<b>Shareholders' Equity</b>	<b>252.9</b>	<b>273.5</b>	<b>287.5</b>
Share Capital	5.1	5.4	5.4
Reserves and Other	246.0	266.9	276.0
Retained Earnings	1.8	1.2	6.1
<b>Current Liabilities</b>	<b>129.8</b>	<b>128.0</b>	<b>141.4</b>
ST Interest Bearing Debt	7.7	11.2	18.2
Trade Payables	76.0	82.7	57.7
Accrued Wages	1.6	2.4	2.9
Accrued Taxes	10.8	3.4	2.5
Other Current Liabilities	33.6	28.4	58.1
<b>LT Liabilities</b>	<b>63.4</b>	<b>105.3</b>	<b>153.0</b>
LT Interest Bearing Debt	26.6	65.4	106.7
Other LT	36.8	39.9	46.2
<b>Total Liabilities &amp; Equity</b>	<b>446.1</b>	<b>506.8</b>	<b>581.5</b>

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