



CONCORDE CAPITAL

Ukraine/ Electricity

Kievenergo

Turning Over A New Leaf

BUY

April 7, 2006

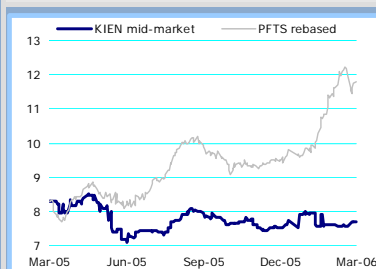
1.50 USD

12m Target

2.25 USD

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KIEN Mid-Market, UAH



Market Information

Bloomberg KIEN UZ
Reuters KIEN.PFT

No of Shares, mln 108.4

Market price, USD 1.50
52Wk H/L, USD 1.67/1.40
MCap, USD mln 162.5
Free Float, % 10.8

Stock Ownership

NC ECU 50.00%
Kiev city 12.73%
Private holders 26.46%
Other 10.81%

Ratios 2005E

EBITDA Margin 6.0%
EBIT Margin 3.2%
Net Margin 1.9%

Net Debt/Equity 0.44

The optimism we expressed about KIEN's future in our August 2005 is starting to look quite warranted. Since March 2006 KIEN has undergone a metamorphosis, it is a completely different company from the one it was six months ago. New regulatory changes allow the company to sell the electricity it produces at competitive prices to the market, while at the same time retain its monopoly on electricity supplies to Kyiv. We reinforce our BUY recommendation, with a 12m target upgrade to USD 2.25

The company has completely changed its business model to its benefit. Before KIEN was a closed-cycle company which produced electricity and sold it to its customers through non-transparent schemes. Now the company sells all its electricity to the Wholesale Electricity Market (WEM) at competitive prices, and then sells electricity from WEM to its customers. This new sales pattern allows KIEN to double its earnings:

- First, by selling electricity to WEM at a higher prices than ever before, the company is able to substantially boost the profitability of its generation segment (by about USD 15 mln p.a).
- Second, by purchasing electricity from WEM (at lower prices than it sells to WEM) and then selling it to end users.

New Power Unit Going On-line In 2008. This unit will increase KIEN's electricity output to WEM by about 25%, further increasing the company's exposure to the profitable wholesale market segment.

KIEN's Profitability: GAS PROOF. Unlike many Ukrainian companies KIEN has nothing to fear from higher gas prices as all the costs related to electricity generation are automatically compensated via KIEN's tariffs which are now set on the hourly basis.

Heating Problems To Be Solved? The heating segment's lack of profitability is still a problem, however, a document that should partially solve it has been drafted. **WATCH.**

Kievvodokanal (KVKL) To Make Good On Its USD 35 mln Debt. Kievvodokanal has recognized its debt to Kievenergo, though, the later did not do the same for KVKL. As a result, KIEN obtains about USD 0.08 mln monthly from KVKL as repayment of this past debt.

KEY FINANCIAL DATA, USD mln

	Net Revenue	EBITDA	Net Income	DPS, USD
2004	310.2	19.2	9.7	0.005
2005E	352.5	21.1	6.8	0.001
2006E	586.4	35.9	15.5	0.034
Spot Exchange Rate		5.05		

KEY RATIOS

	EV/S	P/E	EV/EBITDA	Div Yield
2004	0.75	16.7	10.1	0.3%
2005E	0.66	23.9	11.0	0.1%
2006E	0.40	10.5	6.9	2.3%

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METAMORPHOSIS

Important changes occurred in September 2005 and February-March 2006, which we believe will change investors' attitudes towards the company.

In our last report on KIEN (August 15, 2005), we said that we expected KIEN to stop selling electricity according to the tariffs pre-determined by the NERC and start selling all electricity on the capacity tender market. KIEN entered the capacity tender market earlier than we expected. Since March 1, 2006, (we predicted they would make this move in early 2007) the company has been officially participating on the capacity tender market.

KIEN And The Capacity Tender: What Benefits?

Since February 2006, the CHPPs operated by KIEN have been supplying electricity according to the rules of the capacity tender market (for a trial period). These CHPPs began to be paid for the electricity they produced according to the capacity tender rules in March 2006. This rules set a higher price than the one at which the wholesale market bought from KIEN before.

All the power plants participating in the capacity tender are paid for their electricity in the following way:

- For the electricity they produce, all companies are paid the marginal price of the system (MPS), which is the price for the most expensive maneuverable power unit working in the system on a given hour.

Today MPS is about 31 USD/MWh, which is 61% more than the price KIEN 's CHPPs were paid in February (19.2 USD/MWh).

- In addition, all the companies participating in the capacity tender obtain additional payments:
 - o Capacity payment (is paid between 7 am and 11 pm, equal to 3-5 USD/MW of working capacity)
 - o Maneuverability payment – paid for changes in working capacity during the day, equal to 0.6-50 USD per MW of incremental capacity, depending on the period of the day and the decision of the regulator.

In 2005, Kharkiv CHPP-5 (close in profile to KIEN's CHPPs) obtained additional surcharges amounting to USD 5-11 per MWh of electricity sold.

On the following page we examine Kharkiv CHPP-5 (H-5) which has been participating in the capacity tender since 2003. This power plant is similar to CHPP-5 and CHPP-6, both of which are operated by KIEN.

Comparison Of KIEN And Kharkiv CHPP-5

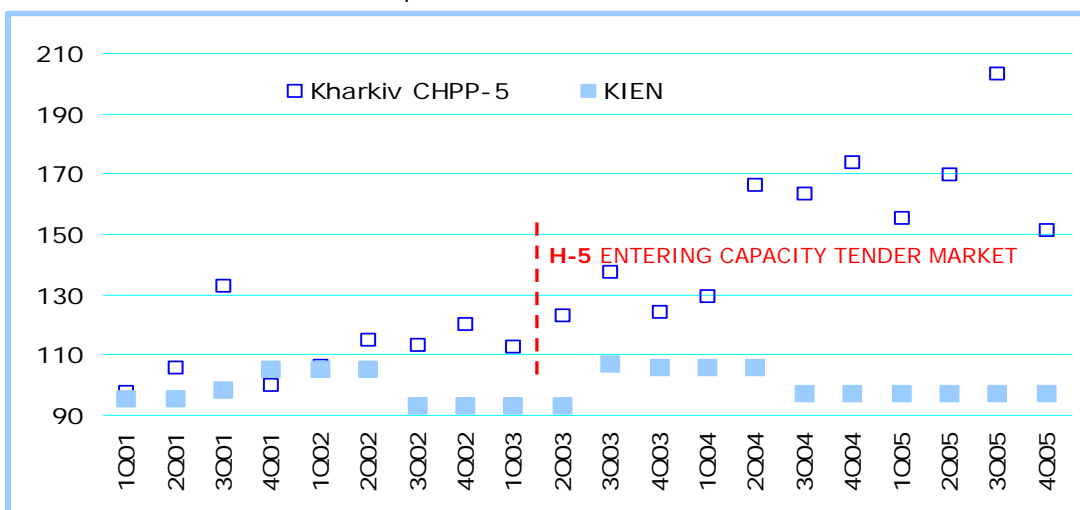
	Installed Capacity MW	Commissioned in...	Fuel	Fuel Efficiency* 10M05
Kiev CHPP-5				
Unit#3	250	Sep-74	Gas/oil	48%
Unit#4	250	Jul-76	Gas/oil	48%
Kiev CHPP-5				
Unit#1	250	Feb-82	Gas/oil	53%
Unit#2	250	Sep-84	Gas/oil	53%
Kharkiv CHPP-5				
Unit#3	250	Jul-90	Gas/oil	39%

Source: company data, Energobusenes, Concorde Capital
 * % of fuel energy which is transformed in electric energy

Kharkiv CHPP-5 (H-5): A Role Model

Kharkiv CHPP-5 entered the capacity tender market in April 2003, this move has positively affected the company's electricity price and financials.

Before entering the capacity tender market Kharkiv CHPP-5 was assigned prices according to the fixed annual tariff approved by the NERC (similar to KIEN's tariff before March 2006). However, since April 2003 the company's price has been determined by the competitive conditions of the capacity tender market.

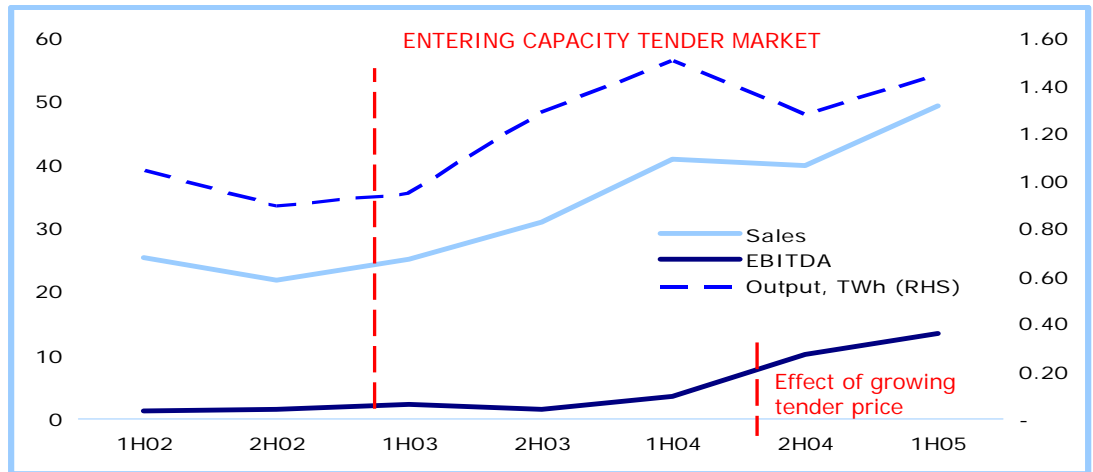
KIEN And Kharkiv CHPP-5 Tariffs, UAH/MWh


Source: NERC, Concorde Capital

Note that tariffs for KIEN's CHPPs have been stable since 2001, while tariffs for electricity produced at H-5 have increased by about 50% since that time. Moreover, demand for the company's electricity has increased, so that output of H-5 raised in 2005 by 33% compared to 2002.

Further, when tariffs on competitive market started growing since mid 2004, the company's EBITDA has increased significantly (refer to the chart below).

Kharkiv CHPP-5 Financial Results, USD mln



Source: company data, Concorde Capital

We expect KIEN to sell its electricity to WEM at a price similar to the tariffs of Kharkiv CHPP-5 (but probably a bit lower) starting from March 1, 2006.

So What Changed?

Until September 2005, KIEN produced electricity at its CHPPs and distributed it to its consumers. If the amount generated was not enough to cover consumer needs, KIEN bought part of the electricity it needed from the wholesale electricity market (WEM). Conversely, if KIEN had excess electricity it sold it to WEM (for more details refer to our KIEN report of 15 August 2005).

When the government began implementing its new retail tariff policy for Ukraine in September 2005, they changed KIEN's schedule of electricity sales.

We can divide the changes into two stages:

- transition changes (Sep. 1, 2005 – Feb. 28, 2006), when KIEN started selling all the electricity it produced to WEM at the same price it earlier sold it to its distribution segment
- final changes – since March 1, 2006 – when KIEN started selling electricity at the price set by the capacity tender

1. Selling Electricity Twice

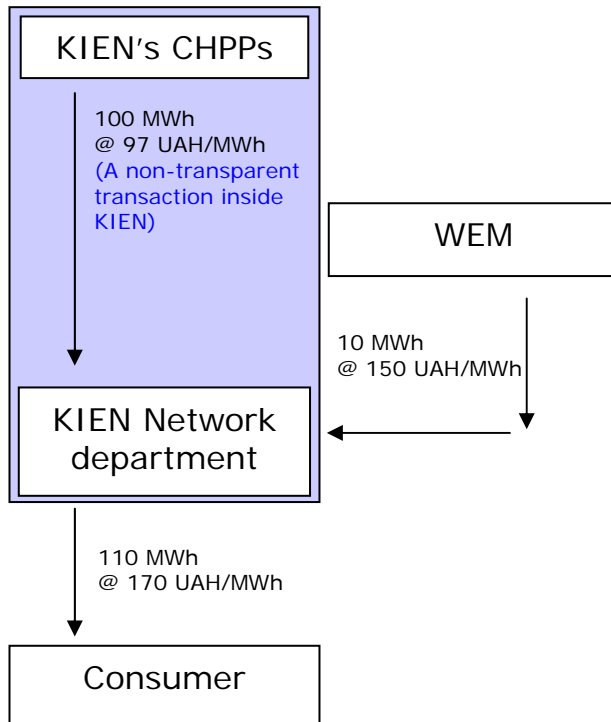
From September 1, 2005 until February 28, 2006, KIEN sold energy in a different way: KIEN's CHPPs sold all the electricity they produced to WEM, and then the KIEN network department purchased the electricity from WEM and sold it to consumers.

This means KIEN "sold" its electricity twice: while *de facto* most of the electricity produced at KIEN's CHPPs went directly to the company's consumers, *de jure* KIEN "sold" this electricity to WEM and then "bought" it again at the same price, and "re-sold" it to end users. These changes in the way the company bought and sold electricity affected both the revenues and the costs of the company, but did not alter profits.

Example

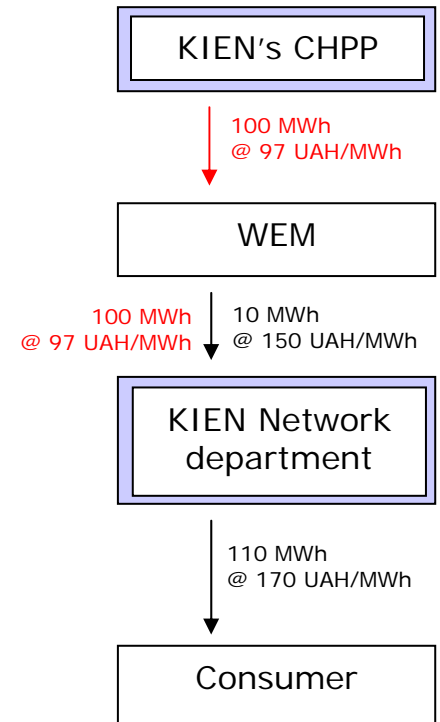
Suppose KIEN produces 100 MWh of electricity at costs of 90 UAH/MWh. KIEN sells 110 MWh of electricity to its consumers (i.e. 100MWh produced by itself and 10 MWh bought from WEM) at 170 UAH/MWh. It sells the electricity it produced at 97 UAH/MWh. The wholesale market price for electricity (for distribution companies) is 150 UAH/MWh.

Old Model (Before 1 Sep 2005)



<p>Sales: $110 \times 170 = 18,700$ - revenue from sales to end user</p> <p>Costs: $100 \times 90 = 9,000$ - production costs $10 \times 150 = 1,500$ - purchase costs Total: 10,500</p> <p>Profit: 8,200</p>

Transition Model 9/1/05 -2/28/06



<p>Sales: $110 \times 170 = 18,700$ - revenue from sales to end user $100 \times 97 = 9,700$ - revenue from sales to WEM Total: 28,400 (grew 9,700)</p> <p>Costs: $100 \times 90 = 9,000$ - production costs $10 \times 150 + 100 \times 97 = 11,200$ - purchase costs Total: 20,200 (grew 9,700)</p> <p>Profit: 8,200 (no change)</p>
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Conclusions:

KIEN's sales and costs both grew by the same amount (the value of electricity produced at its CHPPs), thus the reforms, Sep 2005- Feb 2006, did not affect KIEN's profit.

If before September 2005, it was possible to divide KIEN into two parts (electricity and heating), now there are three divisions: electricity generation, electricity distribution, and heating. **This allows KIEN to deal with its segments more independently and therefore, it is possible to more explicitly evaluate KIEN's generation and distribution segments separately.**

2. Sell Expensive, Buy Cheap And Sell Again

On March 1, 2006, the way electricity is bought and sold changed again. Now KIEN sells all its generated electricity to WEM at the capacity tender price, and then it buys all electricity from WEM at the same price that all the other Oblenergos pay.

Note that now the *price at which KIEN sells its electricity to WEM* may be higher than the *price at which KIEN then buys electricity from WEM*. This is due to the pooling system used by the local energy market, where expensive and cheap electricity from different sources is mixed (see the next section).

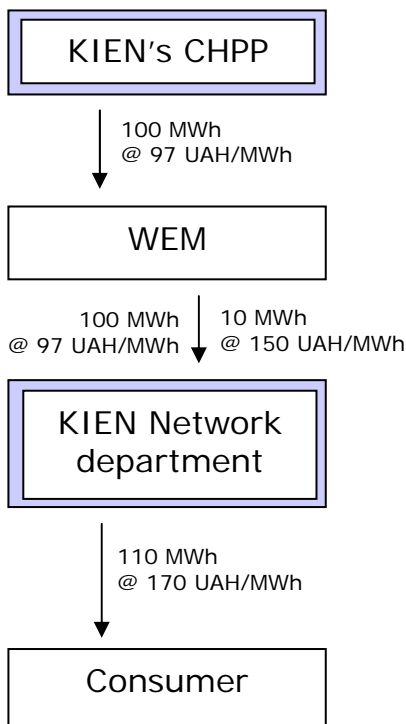
We expect KIEN to sell electricity for about 160 UAH /MWh, and buy it back at 153 UAH/MWh in March 2006.

This change will allow KIEN to increase both its sales and income.

Example, Continued

Assume KIEN sells electricity to WEM at 160 UAH/MWh in accordance to these new conditions. The other assumptions are the same as before.

Transition Model 9/1/05 -2/28/06

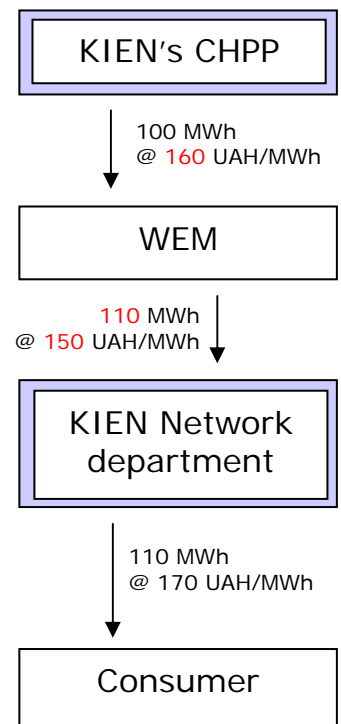


Sales:
 $110 \times 170 = 18,700$ - revenue from sales to end user
 $100 \times 97 = 9,700$ - revenue from sales to WEM
Total: 28,400

Costs:
 $100 \times 90 = 9,000$ - production costs
 $10 \times 150 + 100 \times 97 = 11,100$ - purchase costs
Total: 20,200

Profit:
 8,200

New Model (Since Mar 1, 2006)



Sales:
 $110 \times 170 = 18,700$ - revenue from sales to end user
 $100 \times 160 = 16,000$ - revenue from sales to WEM
Total: 34,700 (grew 6,300)

Costs:
 $100 \times 90 = 9,000$ - production costs
 $110 \times 150 = 16,500$ - purchase costs
Total: 25,500 (grew 5,300)

Profit:
 9,200 (grew 1,000)

Thus, this new model implied an increase in both sales and income.

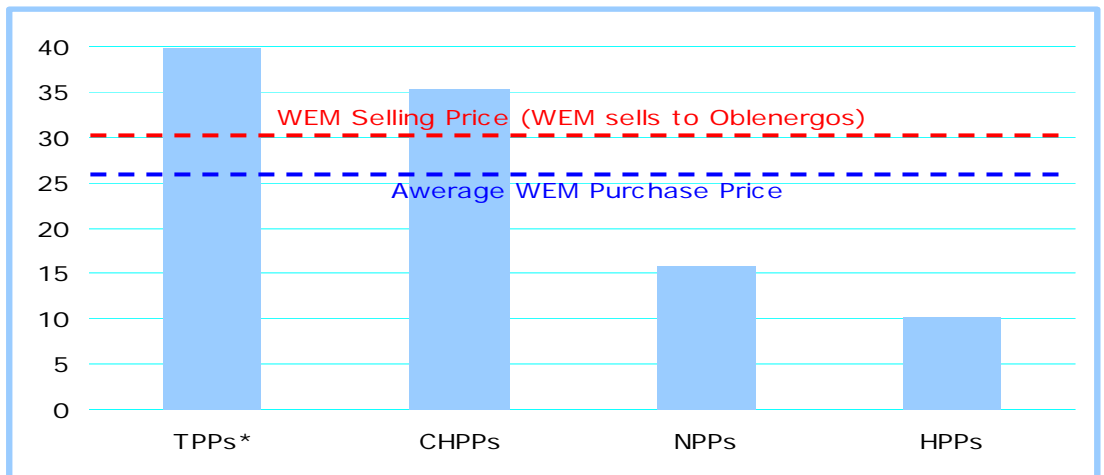
Note that KIEN's costs related to electricity production at the capacity tender market (new model) may increase because the capacity tender market implies the company will see a more irregular load of power units than base load segment in which it operated before. Thus, the real effect on KIEN's profits of KIEN will be not as high as in our example, but still it would be close to it.

Is It Possible To Sell Expensive And Then Buy Cheaper?

It seems crazy, but yes. This is because KIEN's CHPPs now not only produce electricity, but also participate in the process of regulating the capacity load in the whole energy system. Thus, the electricity generated by KIEN's power plants is now more valuable for WEM than the electricity which goes from WEM to KIEN's customers.

Note that the price at which the capacity tender participants sell electricity to WEM is larger than the price at which Oblenergos buy it from WEM: this is because in the pooling process used by WEM the price is based on average price of different producers:

Selling Prices Of Power Generators And WEM, March 1-10, 2006, USD/MWh



Source: Energorynok WEM operator
 * all TPPs are capacity tender participants

Note also that KIEN's profit in our example above (page 8) has increased by the amount of electricity produced (100 MWh), times the difference between the price at which KIEN sells the produced electricity to WEM and price at which it buys it back from WEM again:

Sell to WEM 100 MWh @ 160 UAH/MWh;
 Buy from WEM again : 100 MWh @150 UAH/MWh =>
 net gain = $100 * (160 - 150) = 1,000$ UAH

This difference in prices reflects the premium WEM is ready to pay for KIEN's role as a participant in the regulation of the network's total capacity.

Important Implications Of The Structural Changes

One of the most important implications of the changes in KIEN's pricing and selling policy is that *de facto* KIEN now consolidates two independent departments: generation which can be compared to other Ukrainian GenCos, and distribution which can be compared easily to other Oblenergos. Thus, KIEN has changed its structure from a company which sells the electricity it produces to its own consumers (using mostly non-transparent cooperation between its generation and distribution segments) into a company which both, generates and distributes electricity according to the market rules.

Another implication is a direct increase of KIEN's profitability due to its sale of electricity at the capacity tender, i.e. at higher price than before. Roughly:

The net economic effect of the change in KIEN's business model is the difference between the price at which KIEN sells electricity to WEM, and the price at which it buys electricity back. The gain is estimated to be about 2 USD/MWh, or about USD 15 mln annually.

The GENERATION SEGMENT

The Competitiveness Of CHPPs

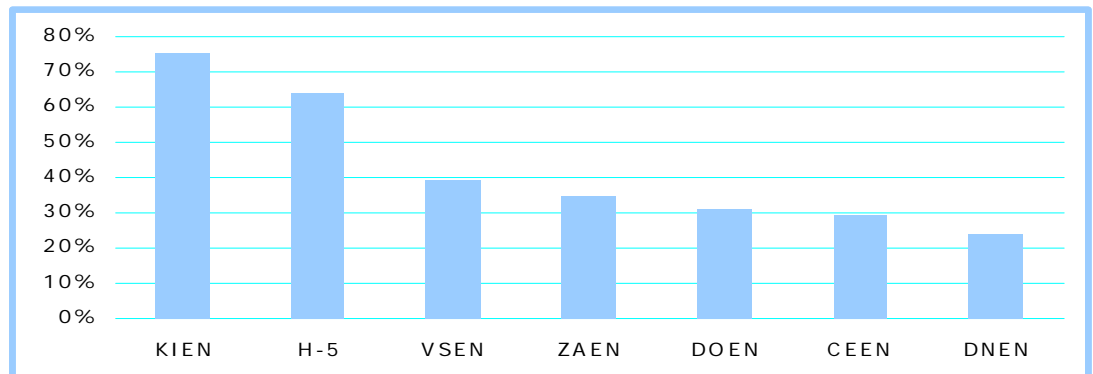
After entering the capacity tender market, KIEN's generation units started working in a new mode. Before they mainly worked in base load mode, now they work in maneuverable mode (i.e. they change capacity or even stop if there is capacity surplus on the market). In addition, now their output depends on the price of electricity they supply: if its price comes out higher than its competitors at the capacity tender, the work of KIEN's units can be limited.

Thus, now it is important to analyze how the capacity tender will affect KIEN's output. Fortunately, as the experience of Kharkiv CHPP-5 shows, if CHPPs enter the capacity tender segment, their output does not decrease. This is because heat and power stations have considerable advantages over thermal power plants:

- CHPPs' electricity is less expensive (i.e. more price-competitive) at the capacity tender market
- Co-generation feature (need to produce heat) does not allow electricity dispatchers to limit work of CHPPs even they appear non-competitive price-wise

Because of these features, we expect KIEN to remain one of the most highly utilized GenCos, even after the company enters the capacity tender.

Capacity Utilization, 10M05*



Source: *Energobiznes*, Concorde Capital calculations

* For CEEN and DNEN only coal-fueled power units are accounted

Moreover, the company has the potential to increase its capacity utilization: due to fuel limitations KIEN under-produced (according to the plan) by 7% in 2005, and 33% in January 2006. Thus, if KIEN is able to solve its gas payment problems (refer to the section below), it would even increase its capacity load.

Gas Supply Limits: An Old Problem

The company has been suffering from its clients poor payment discipline and pressure from Gaz Ukrainy since 2003, and thus has had its gas supplies limited due to its gas debts. Between February 22 and 25, 2006 KIEN had to stop power unit #2 in Kyiv CHPP-6 due to a lack of gas supplies.

There is no doubt that gas supply limits negatively affect the company's financials. When its gas supplies are limited the company has to buy an additional portion of electricity at WEM at a higher price than it would have cost to produce it.

There is a bright side to this situation. When gas supplies are limited KIEN decreases its heat supply, but does not reduce heat revenues, as most of the consumers pay a fixed fee for heating. In the midterm, when the current heat tariff rules take effect, this will slightly cushion the blow.

Solution In Sight?

Note that Kremenchug CHPP (run by Chernihivoblenergo, CHEON) and Kharkiv CHPP-5 do not have this problem, despite the fact that they both (like KIEN) use gas and produce heat.

CHEON was able not only to solve its problem, but also to agree with the Kremenchug administration on a heat tariff which covers CHPP's heat production costs.

For KIEN the problem is worse than for CHEON because:

- KIEN's customer base is much larger than Kremenchug CHPP's (in fact, CHPP has one large industrial consumer, and small city).
- Unlike CHEON, KIEN is not in the position to lobby for an increase heating tariffs in the metropolitan Kyiv area.

However, one way out would be for KIEN to increase payment levels for both heat and electricity, which remain some of the lowest in Ukraine. Kyiv's housing services which used to be responsible for collecting money for heating services, have shown themselves to be completely incapable of doing this task effectively. The Kyiv city council recently decided to allow KIEN to take care of this task itself.

Direct Supplier Of Services

Kyiv city published a order in February 28, according to which KIEN is recognized as a supplier of electricity and heating services to Kyiv citizens. It looks like the decree was designed to help KIEN solving the problem of low payments for the heat it supplies: now the company (not housing organizations) can collect payments for heat services directly from consumers.

However, so far the decree has brought more trouble than benefits. According to the company, it is now obliged to maintain heating networks inside buildings and to sign direct contracts for heat and hot water supplies with each consumer. All this requires a large amount resources from KIEN. Thus, the company asked the mayor of Kyiv to repeal this decree.

Taking into account KIEN's response to the Kyiv city decree, we believe the company is not ready to solve its low payment discipline problems.

Other Important Issues:

Gas Price Growth: Short Term Hassle

Despite the fact that KIEN uses gas for more than 99% of its electricity production (the remaining 1% is oil which is used as a reserve fuel), the change in gas prices have not affected the company's profitability, because KIEN buys about 50% of its gas at special tariffs, because it generates heat. The gas tariff for heating companies is 40% lower than the price thermal power plants pay for gas (i.e. used for electricity production).

Note, however, that since January 2006, gas for heating purpose has risen 25% in price, while KIEN's heat and electricity tariffs have not changed. This may have led to KIEN's poor financial showing in 1Q06. Still, we expect the company's arrival on the capacity tender market and corresponding increase of electricity tariffs to positively affect KIEN's profitability in the subsequent quarters of 2006. Starting in March 2006 we expect all the input prices to be reflected in KIEN's tariff for electricity produced.

New Power Unit To Go Online By 2008

Kievenergo is building a new power unit (250 MW) at Kyiv CHPP-6, which will increase the combined electric capacity of the company by 21% once it is completed (expected in 2008, we originally expected it to be finish in mid 2007 - see our August report).

This will allow KIEN increase the amount of electricity sales to WEM by about 25% in 2008. The management plans to borrow the remaining USD 50 mln needed to finish construction from a German bank. Construction of the unit is being partially financed by the state, from KIEN sources, and from a special surcharge to KIEN electricity tariff.

Rent To Own?

Investors feel the key risk for KIEN's generation segment is the ownership of CHPPs operated by KIEN. As the privatization of heat energy objects, like CHPPs, is prohibited in Ukraine, KIEN was not allowed to obtain ownership rights for these power plants. Thus, power plants are owned by Kyiv city, but KIEN has spent a great deal of money to upgrade the units, which means part of the energy equipment located at CHPPs is KIEN's property. For this reason it would be hard (or legally impossible) to separate the generating equipment from the company.

Note also that KIEN is not interested in have the moratorium on the privatization of heating units removed in the future, as it is unwilling to pay for them. We believe KIEN will continue "renting" CHPPs in the future, as this situation is convenient for both parties:

- The lessor, Kyiv city, because it does not having to deal with the headaches of operating production units
- The lessee, KIEN, as *de facto* it is the full-fledged owner of CHPPs

THE HEATING SEGMENT: AN ETERNAL BURDEN?

Currently the heat and hot water tariffs, set by the local administration, do not cover KIEN's cost of their production, despite the fact that the law on housing services (adopted in 2004) stipulates that all services have to be priced at least at cost.

The last time the tariff for hot water was revised was in 2002, however the Kyiv city council has prepared a decree that will increase the tariff by four times.

The Kyiv council did not want to risk passing this law before the elections, (this decree was scheduled to be heard on March 9), however, we expect these changes to take effect by 2007.

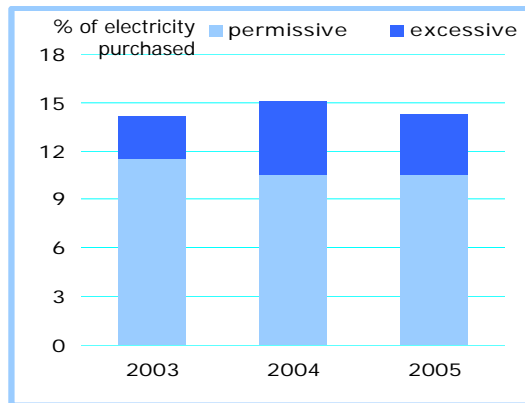
In addition to this draft, Kyiv city plans to push through reforms that will price all housing services (including heat production) at a level that will give service providers a 5% profit. The change in the Kyiv administration after the March elections could cause these plans to be revised or at least postponed.

In any case, we expect cities to pay more attention to the problems of the heating and water sector in the near future. Thanks to the lessons from last winter's heating disaster in the city Alchevsk, which left hundreds thousands of people without heat, policy makers have begun to pay more attention to the housing sphere. Thus, we have become more optimistic about the prospects for KIEN's heating sector profitability, but at the moment it is difficult to forecast when these changes will occur. **WATCH.**

DISTRIBUTION: NOT ENOUGH POSITIVES

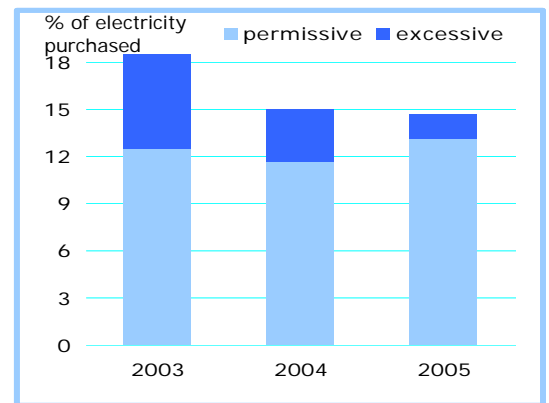
KIEN's electricity distribution department is one of the least efficient in the Ukrainian distribution sector: the company has a low payment collection level and excessive electricity losses in the grid, above the average Ukrainian level in 2005. Due to the fact that the company is only compensated for a permissive level of electricity losses, excessive losses take a chunk out of the company's profits. According to our estimates, KIEN lost more than USD 5 mln due to excessive electricity losses in 2005.

Electricity Losses In KIEN's Grid, 2005



Source: Energobiznes

Electricity Losses In Ukraine On Average



The main culprits behind KIEN's high amount of excessive electricity losses are outdated electricity meters. Old meters tend to under-state the amount of electricity consumed, thus, the real amount consumed is not reflected by the meter.

In 2004, the company started changing electricity meters in Kyiv, and this led to a slight decrease of excessive electricity losses in 2005, and we expect these losses to continue to decline in the future as the company changes more meters.

KIEVVODOKANAL CONTROLLED BY KIEN?

Last summer one of KIEN's top managers was elected by the AGM of Kievvodokanal (KVKL) water and sewage company as the general director of KVKL. Since this new manager's arrival most of the important positions in the company have been occupied by former KIEN managers, thus KIEN has *de facto* acquired KVKL.

KIEN's 'takeover' of KVKL marks the end of the conflict between the two companies. In the summer 2005 KVKL claimed KIEN owed them about USD 30 mln for the water the company supplied, while KIEN insisted that KVKL owed them about USD 35 mln for the heat it supplied KVKL.

With election of KIEN's man as the new CEO at KVKL, the water company recognized its debt to KIEN, restructured it over 12 years and started re-paying it. This move does not look very good for KVKL, a loss-making enterprise, in fact the company is close to being declared bankrupt. Thus KVKL's management focused more on KIEN's needs than those of their own company. KIEN now seems on the verge of acquiring KVKL.

Who Needs Sewage?

Despite these events, we do not believe that KIEN will actually acquire KVKL, as there seems to be no reason for the company to take on a loss making water and sewage company. However, it is still a possibility. **WATCH.**

The most important and beneficial for KIEN implication of KVKL's management change is the company's decision to pay back its debt to KIEN.

VALUATION

International peer valuation

Valuation Summary

	MCap USD mln	EV/S			EV/EBITDA			P/E		
		2004	2005	2006E	2004	2005	2006E	2004	2005	2006E
CEZ	20,941	5.64	4.26	3.61	14.8	12.3	9.0	40	23	20
Enel	51,784	1.88	1.63	1.70	6.7	6.4	6.8	15	11	15
Vattenfall	11,882	0.97	0.95	n/a	6.5	n/a	n/a	35	n/a	n/a
EnBW	15,190	1.69	1.47	1.41	8.4	8.1	6.5	39	n/a	15
Endesa	34,450	2.96	2.76	2.74	9.5	11.8	8.2	20	35	23
Group average		2.6	2.2	2.4	9.2	9.7	7.6	29.8	23.1	18.4
Group median		1.9	1.6	2.2	8.4	10.0	7.5	35.5	23.4	17.5
KIEN	163	0.74	0.65	0.39	11.9	9.7	5.4	17	19	8
Implied upside		<i>218%</i>	<i>213%</i>	<i>661%</i>	<i>-42%</i>	<i>4%</i>	<i>54%</i>	<i>112%</i>	<i>22%</i>	<i>115%</i>
Implied price, USD		<i>4.77</i>	<i>4.70</i>	<i>11.41</i>	<i>0.87</i>	<i>1.56</i>	<i>2.31</i>	<i>3.18</i>	<i>1.82</i>	<i>3.23</i>

Source: company data, Bloomberg, IBES, Concorde Capital estimates

This method gives various estimates of KIEN's price, but it suggests KIEN is undervalued compared to international vertically integrated electricity companies.

To more precisely estimate KIEN's implied price we also value the company using Ukrainian peers and DCF.

Local Peer Valuation: Sum Of The Parts

KIEN is unique in that it is a vertically integrated electricity company, with no analogs in Ukraine. This made it impossible to value the company using local peers directly. Now, with explicit separation of KIEN's generation and distribution segments, we can value the company using a separate valuation of these two segments.

Note that in our valuation we ignore the company's unprofitable heating business. We assume the negative effect of the heating segment on KIEN's valuation is offset by synergies from being a vertically integrated electricity company.

Generation Segment

	MCap USD mln	EV USD mln	EI. Production, TWh		EV/EI.Prod., USD/MWh	
			2005	2006E	2005	2006E
CEEN	347.5	345	12.2	12.7	28.24	27.15
DNEN	276.6	312	13.2	13.8	23.58	22.67
DOEN	128.2	205	7.3	7.6	28.09	27.01
ZAEN	345.3	407	14.9	15.0	27.31	27.10
Mean					26.81	25.98
KIEN			8.0	8.5		

Implied Generation EV, USD mln **214.8** **220.9**

Source company data, Energobiznes, Concorde Capital estimates

Note that Ukrainian distribution companies are mostly illiquid, therefore it is hard to find reliable market prices for most of them. Thus, in valuation by distribution peers, we consider only the most liquid companies: Dniiproblenergo (DNON), Zaporizhiaoblenergo (ZAON) and Kharkivoblenergo (HAON).

Distribution Segment

	MCap USD mln	EV USD mln	EI. Supplied, TWh		EV/EI. Suppl., USD/MWh	
			2005	2006E	2005	2006E
HAON	71.8	71.8	4.83	4.98	14.9	14.4
ZAON	143.5	143.5	10.02	10.22	14.3	14.0
DNON	231.3	231.3	25.60	26.37	9.0	8.8
Mean					12.7	12.4
KIEN			7.42	7.79		

Implied Distrib. EV **94.5** **97.6**

Source company data, Energobiznes, Concorde Capital estimates

Total (Gen. + Distr.) Implied EV, USD mln **309.3** **318.5**

Implied KIEN MCap, USD mln **242.8** **252.0**

Implied Share Price, USD **2.24** **2.33**

Implied Upside **49%** **55%**

DCF Model

The current model differs from the previous (described in our August 15, 2005 report) in four important ways:

- KIEN has entered the capacity tender market nine months earlier than we expected
- KIEN new power unit will be ready a half year later than we expected (2008)
- The company's CapEx forecast for 2005-2007 increased, in line with the new plans of KIEN's management
- We apply lower WACC to reflect investor's shift in perception to Ukrainian stocks (please refer to our Equity Strategy Report of March 28, 2006).

All the other assumptions of the model are similar to those reflected in our previous report.

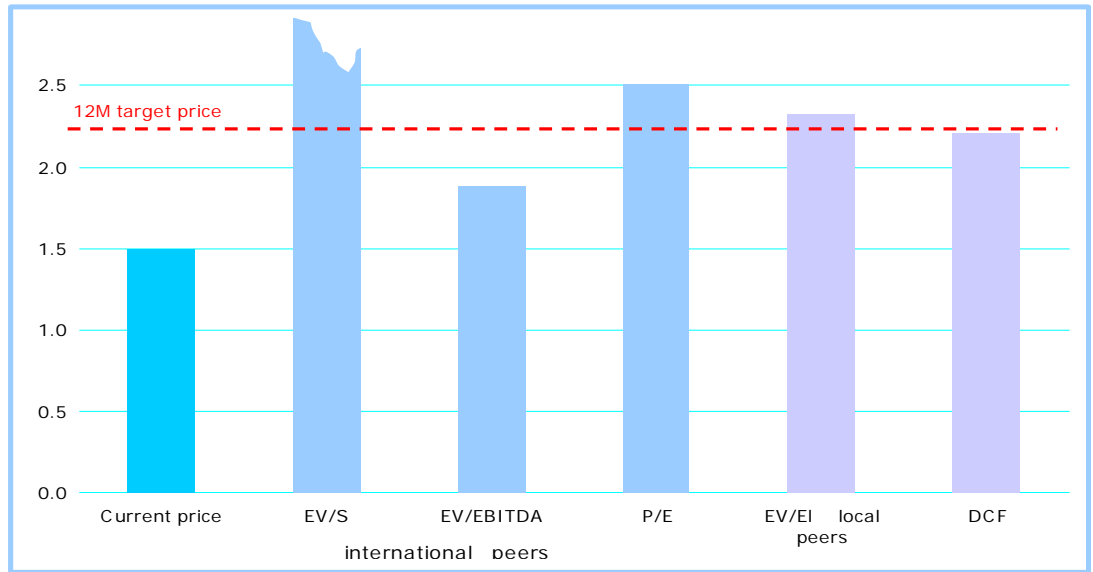
Valuation date	3-Apr-07									
<i>For the purposes of forecasting local currency is used (mln)</i>										
	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
EBITDA	106	180	205	271	303	331	343	351	359	367
EBIT	57	126	146	194	220	245	254	260	266	271
Tax Rate	1%	15%	17%	19%	20%	21%	21%	22%	22%	22%
Taxed EBIT	56	107	122	157	175	194	200	204	208	211
Plus D&A	49	54	59	77	84	87	89	91	93	96
Less CapEx	(220)	(220)	(194)	(140)	(128)	(111)	(101)	(98)	(96)	(96)
Less change in OWC	(25)	(30)	(19)	(46)	(2)	(15)	(4)	(7)	(7)	(1)
FCFF	-	-	(33)	47	129	154	184	190	198	210
WACC	12.4%	11.5%	10.6%	10.5%	10.3%	10.2%	9.9%	10.0%	10.1%	10.1%
WACC To Perpetuity										12%
Terminal Value										2,138
Firm Value			1,647				Portion Due To TV			61.2%
Less Net Debt			449				Perpetuity Growth Rate			2.0%
Equity Value			1,198				Implied exit EBITDA multiple			5.8x
DCF-based 12m price, USD			2.21							
Current stock price, USD			1.50							
Upside			47%							

Sensitivity Analysis

Implied Share Price, USD					
WACC	Perpetuity Growth Rate				
	1.0%	1.5%	2.0%	2.5%	3.0%
-1.5%	2.30	2.40	2.51	2.63	2.76
-1.0%	2.21	2.30	2.41	2.52	2.65
-0.5%	2.11	2.21	2.31	2.42	2.54
+0.0%	2.03	2.11	2.21	2.32	2.44
+0.5%	1.94	2.03	2.12	2.22	2.34
+1.0%	1.86	1.94	2.03	2.13	2.24
+1.5%	1.78	1.86	1.95	2.04	2.15

Valuation Summary

Implied 12M Price Summary, USD



Source: Concorde Capital

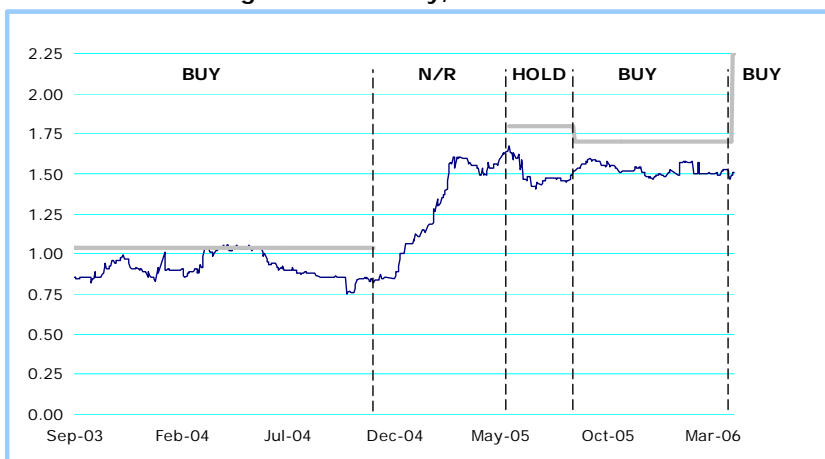
In selecting the target price for KIEN, we refer to all the implied prices estimated in previous subsections. However, we base our target mainly on local peers and our DCF model, which gave close results.

KIEN's 12M target is USD 2.25 (which implies a 50% upside), we maintain our BUY recommendation.

Analyst Certification

I, Alexander Paraschiy, 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.

Stock Price And Target Price History, USD



Alexander Paraschiy

Date	Closing Price, USD	Target Price, USD
31-Mar-06	1.50	2.25
15-Sep-05	1.55	1.70
27-Jan-05	1.40	1.70
13-May-05	1.62	1.80
2-Sep-03	0.85	1.04

The stock was covered by analysts currently engaged with Concorde Capital prior to legal inception of the company in Oct 2004, recommendations are supported by research

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