



CONCORDE CAPITAL

BUY

12M Target: USD 4.0

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Market: USD 2.85

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Bloomberg K IEN UZ
Reuters K IEN.PFT
'DRs : absent

Market data

Market price, USD 2.85
52 Wk H/L, USD 2.85 / 1.02

Shares, mln 108.36
MCap, USD mln 309.0

Free float, shares 9.0%
FF MCap, USD mln 27.81

12M target

Price, USD 4.00
12M MCap, USD mln 433.4
Upside 40%

Ownership

State (NC ECU) 50.0%
City of Kiev 12.7%
(Kievenergoholding)
Khmelnitskiy Group 26.0%
Other 11.3%

More news to spur further volatility: a special commission declared Kievenergo's lease of city assets (power plants and heating networks) inefficient. According to Oles Dovgiy, secretary of the Kiev City Council, this will prompt the transfer of the lease to another entity (apparently to Kievteploenergo, which is connected to the city mayor). We question the validity of the commission's findings and do not change our opinion that attempts to discontinue Kievenergo's lease will be neutralized by representatives of the government and Kievenergo's main shareholders. We maintain our BUY recommendation.

Poor Performance...

The key fact that led the commission to this conclusion was Kievenergo's poor financial results compared to Darnitsa CHPP, which is run by JV UkrCanPower: "KIEN's parameters are 26 times lower than those of UkrCanPower," said Oles Dovgiy. According to him, this resulted in delays in payments for gas and low dividend payouts. We believe the commission compared Kievenergo and UkrCanPower's net margins for 2004-2005 and the differences really look stunning:

Net margin	2004	2005
Kievenergo	0.4%	0.3%
UkrCanPower	13.3%	3.7%

Source: Company data

But...

The real reason for Kievenergo's "poor" performance compared to UkrCanPower is higher D&A and interest expenses. In 2005, Kievenergo's EBITDA margin was even higher than its peer.

Common Size Financials, 2005

	Kievenergo	UkrCanPower
EBITDA	7.2%	6.9%
Depreciation	-5.5%	-2.0%
Interest	-0.9%	0.0%
Other income/losses	1.5%	0.0%
Income tax	-1.9%	-1.2%
Net income	0.3%	3.7%

Source: Company data

And...

Nine-month results show Kievenergo is more efficient than UkrCanPower – mainly because Kievenergo managed to cover its heat segment losses by sharply increased electricity segment profits in 2006 (refer to KIEN reports from Apr. 4, 2006 and Jan. 24, 2007).

9M06 Summary

	EBITDA margin	Net margin
KIEN	3.2%	-1.3%
UkrCanPower	-0.8%	-4.7%

Source: Company data, Concorde Capital estimates

Note that Kievenergo and UkrCanPower cannot be compared directly, because they are different sizes and have unique business models.

Thus, Fishy Conclusions

The "analysis" by Kiev City Council representatives looks biased and is directed at "proving" Kievenergo's inefficiency in order to build a stronger basis for not renewing the lease.

What's Next?

Heated Discussions Ahead

The closer it is to the end of the heating season, the hotter the discussion around Kieveno's lease will be. With their "analysis," the Kiev City Council, controlled by Mayor Leonid Chernovetskiy, took a solid step toward substantiating the grounds for stopping Kieveno's lease agreement. Furthermore, we believe that the National Energy Company (NEC ECU), the World Bank, the State Property Fund, the Ministry of Fuel and Energy and other government institutions will argue for Kieveno to continue its lease.

Kievenogoholding's Position

As Oles Dovgij, who is close to Kiev city mayor, explicitly stated the city's intention to give lease rights to Kievteploenergo, we believe Kieveno's largest private shareholder (Vasiliy Khmel'nitskiy group) will also oppose the initiative to stop the lease. Since Khmel'nitskiy's creation, Kievenogoholding, has poor chances to lease Kiev's assets directly, Khmel'nitskiy is likely to do his best to keep indirect control over Kiev's power infrastructure (through Kieveno), i.e. by prolonging the lease.

We Believe Kieveno's Lease Will Be Prolonged

We believe the mayor's opponents have enough arguments for Kieveno to continue leasing the city's heating infrastructure. The final decision on the lease agreement is expected in April-June 2007. At the moment, we remain optimistic that Kieveno will prolong its lease and support our 12M target at USD 4.0 and our BUY recommendation, despite expected news-driven volatility in the stock's price in the short-term.

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