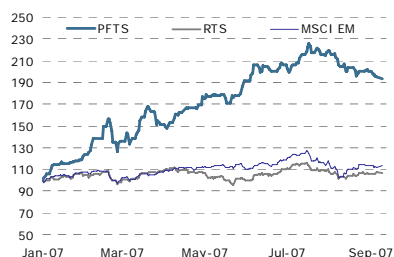


Analyst Notebook

September 20, 2007

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PFTS relative performance



Source: Bloomberg

Key market data

PFTS Index as of 19 Sep 2007 982.38
 Index chg YTD / 1m / 1y 97%/-4%/138%
 MSCI EM YTD / 1m / 1y 26%/15%/47%
 Total MCap of PFTS listing USD 77.2 bln
 Investable Universe MCap USD 68.1 bln
 Investable Universe FF USD 4.8 bln
 PFTS avg daily tr vol YTD USD 6.0 mln

PFTS index basket

	Ticker	Weight %
Zakhidenergo	ZAEN	11.79
Dniproenergo	DNEN	11.05
MMK Illich Steel	MMKI	10.9
Centrenergo	CEEN	9.78
Ukrnafta	UNAF	9.41
Nyzhnyodniprovsky Pipe	NITR	8.11
Ukrtelecom	UTEL	7.55
Raiffeisen Bank Aval	BAVL	6.17
Motor Sich	MSICH	4.86
Azovstal	AZST	4.21
Ukrsotsbank	USCB	3.98
Donbasenergo	DOEN	2.8
Concern Stirol	STIR	2.26
Kyivenergo	KIEN	1.93
Luhanskteplovoy	LTPL	1.67
Poltava Iron Ore	PGOK	1.57
Mariupol Heavy Mach.	MZVM	1.07
Sumy Frunze	SMASH	0.88

- The PFTS released updated Exchange Rules that will come into effect Oct. 1.
- With the elimination of the third level of listing, the number of stocks qualifying as listed on the PFTS would formally shrink to 14. The remainder will be eligible for exchange trading just as before
- The PFTS posted a list of fifteen stocks at risk of withdrawal their formally listed status, due to the lack of an application from the issuer or bad liquidity
- Three PFTS index constituents are at risk of leaving the index
- We expect to see most of delisting/index complications to be resolved by October 1
- Overall we evaluate the changes as quite positive – only this message must be spelled out clearly to investors

Listing rules more logical. The PFTS released information that the new PFTS Rules, which were registered with the State Securities & Exchange Commission, will become effective on October 1, 2007. The most important changes include:

- Stocks may be traded on the PFTS either as listed (included in the exchange register) or "not listed" (not included in the exchange register). Previously, the very ability to trade on the PFTS meant the stock was listed - either officially or unofficially
- Listing can only be accomplished at the issuer's request. Previously, unofficial listing was possible without the issuer's consent
- Levels of listing are reduced from the current three to two

Overall, we find that the changes are positive. Just look at the much more transparent structure of the stock universe eligible for exchange trading:

Existing

Level-1	
Official	Unofficial
Level-2	
Official	Unofficial
Level-3	
Official	Unofficial

Source: PFTS, Concorde Capital

New (from Oct. 1)

Level-1
Level-2
Not listed

"Not listed," a technical term, is a misnomer; we suggest viewing this category of traded stocks more akin to the "open" or "broad" market.

However, only a dozen stocks will boast listed status. The listing requirements are so strong that without the Level-3 category (which used to be a haven for less liquid names and obvious junk stocks), only 14 stocks qualify. The fact that more stocks pass the Level-1 test than Level-2 (8 versus 6) signals that the methodology might have an inherent flaw.

The PFTS had no other choice but to bring their regulations into accordance with the SSEC decree adopted in December 2006. The SSEC, in our view, was too progressive in formulating listing criteria that better suit markets at a more developed stage:

	Level 1	Level 2
Fundamentals:		
1.1 Years since incorporation	3	1
1.2 Net assets, at least, mln UAH	100	50
1.3 Net revenue for the last fiscal year, at least, mln UAH	100	50
1.4 No reported losses	2 out of last 3 fin years	last FY
1.5 Number of shareholders, not less than	500	100
Trading data:		
2.1 MCap, at least, mln UAH	100	50
2.2 Posted deals, for each of last 6 months	10	10
2.3 Average monthly trading volumes for past 6 months, not less, UAH mln	1	0.25
2.4 Number of market makers in the security	1	-
2.6 Max bid-ask spread	15	50
2.7 Max vertical spread	15	30

Source: PFTS

Nevertheless, the major reason for exclusion from listed status is the absence of application from the individual issuers.

Candidates to be withdrawn from listed status:

Kyivenergo	KIEN
Alchevsk Iron & Steel	ALMK
Dnipropetrovsk Pipe	DTRZ
Enakievo Steel	ENMZ
Mostobud	MTBD
Mariupol Heavy Machinery	MZVM
Poltava Iron Ore	PGOK
ZaporizhCoke	ZACO
Chervonarmiyska Zakhidna	SHCHZ
Forum	FORM
Krymenergo	KREN
Arcelor Mittal Steel Kryviy Rih	KSTL
Bohdan Automobile Plant	LUAZ
Novomoskovsk Pipe	NVTR
Avdiyivka Coke	AVDK

Source: PFTS

A portfolio manager seeking or having exposure to Ukraine must know what they are getting themselves into and can hardly be surprised with low liquidity, the volatile profits of Ukrainian stocks, or the lack of cooperation on the part of company management. At any rate, it's mostly the matter of naming conventions – a stock that does not qualify for formal listing will still be quoted and traded on the PFTS.

Market impact will be limited, if any. Overall, the new rules do not change much. According to law, corporate pension funds and insurance companies face restrictions for trading in stocks without a listed status. However, these institutions still represent an embryonic segment of demand, while the growing mutual fund industry has no restrictions as to the listing conditions (it is only required that a security should be accepted for trading on a stock exchange – which still holds).

Management initiative is required for three index members to remain. We see the major concern in regards to the PFTS index constituents. Kyivenergo, Mariupol Heavy Machinery and Poltava Iron Ore could leave the basket according to the new rules. From our conversations with PFTS officials, we see that there exists a general attitude that the stocks should stay, and currently many parties are involved in trying to find a way to tackle the problem. The best way out would be to have the companies apply for listing, the odds of which we evaluate as high. Another option is to adjust the wording of the current PFTS Index regulations to the new Exchange Rules, which has its own pros and cons and is up to the PFTS index committee to implement. In ten days we'll see.

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