

**Konstantin Fisun**  
 kf@concorde.com.ua  
**Polina Khomenko**  
 pk@concorde.com.ua

+380 44 207 5037  
 www.concorde.com.ua  
 Bloomberg: CONR<GO>  
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## Analyst's Notebook

Ukraine / Quantitative Market Analysis

### Zaporizhstal: The bad apple that spoiled the PFTS

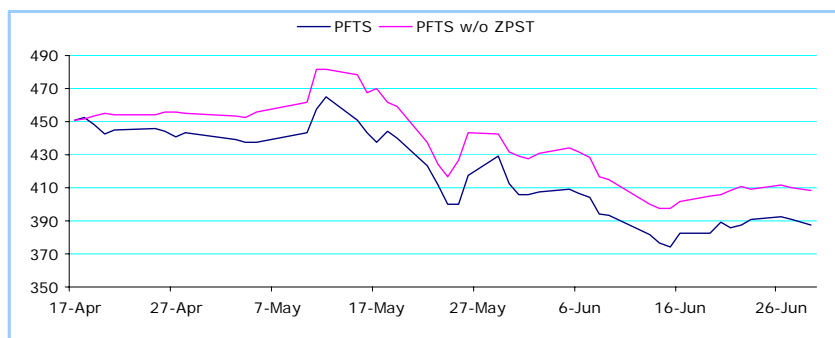
Today, Zaporizhstal's (**ZPST: Susp**) supervisory board today announced its offer for the repurchase of shares from minority shareholders: USD 0.37. The offer is an improvement on the owners' initial offer to buy out at par value, or just USD 0.05. We consider the improved offer to be the result of minority activism involving Concorde Capital.

Nonetheless the announced price is far below minority shareholders' expectations. The consolidation plan approved at the company's June 7 AGM, which would merge Zaporizhstal with five trading companies, would dilute minority shares by more than two times. The market price has fallen by about half since the consolidation plan was announced on April 17: from around USD 1.2 to somewhere between USD 0.5 and USD 0.8 (the current bid and ask quotes). The offer is about 28% below the current market price and 69% below the market price that prevailed before April 17.

The leading local investment banks will continue to stand up for the interests of minority shareholders by pursuing all legal avenues. On July 3 the PFTS reacted to minority shareholder complaints by suspending trading in ZPST stock. The PFTS said it would make a further decision on ZPST on July 10. Depending on the outcome of the buy-out saga, the stock could be downgraded from the PFTS's first-level market or even de-listed.

#### Impact on the Index was significant

##### PFTS index with and without ZPST



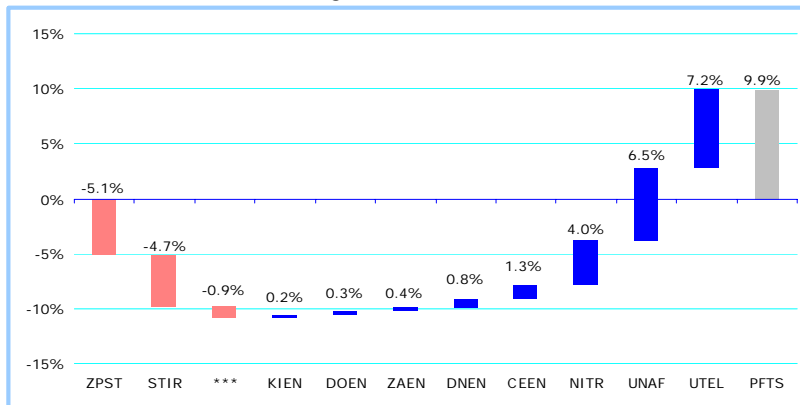
Source: PFTS; Concorde Capital calculations

Note: for simulation of PFTS without ZPST in the basket, mid-market prices were used

Since April, 18<sup>th</sup> ZPST has been the most volatile stock in the PFTS index basket, twice posting a daily drop in excess of 30%. During April 17 - June 29, the PFTS index fell 14.0%, whereas the index simulated without ZPST would have lost only 9.4%. Although the main reason for the break in the market's long-term bullish trend was the global sell-off of emerging markets, Zaporizhstal by itself accounted for some one-third of the PFTS index's fall.

Looking at the PFTS's movements since the beginning of the year, we find that two bad apples spoiled the whole bunch – STIR (because of the gas price increase) and ZPST. NITR, UNAF and UTEL managed to save the day:

**Growth Attribution Analysis, YTD as of 29.06.06**



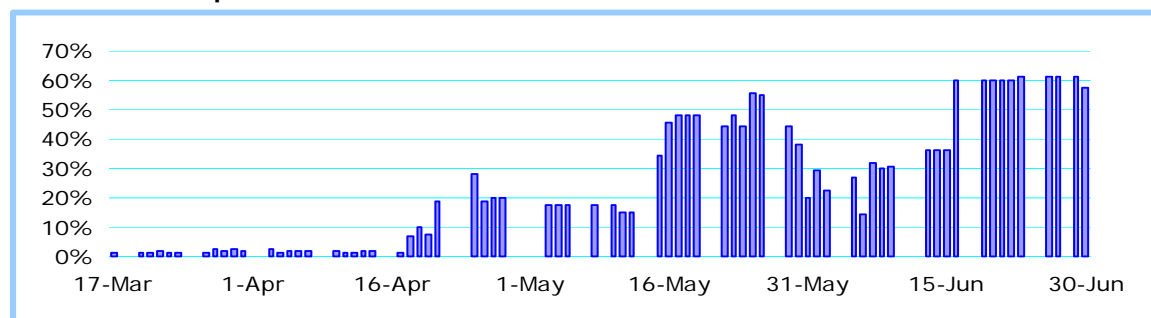
Source: PFTS, Concorde Capital calculations.

Note: \*\*\* accounts for the mismatch, due to the effect of inclusion of BAVL and LTPL into the index since May

**Could ZPST be excluded from the index?**

Another measure the PFTS might take would be to permanently exclude ZPST from the PFTS index. Such a decision could be taken in connection with a downgrade of ZPST from the PFTS's first-level market. ZPST does not currently meet the technical requirements for first-level stocks, which include a maximum 15% spread between bid and ask quotes. ZPST quotations have significantly exceeded the 15% limit since mid-April (see the chart below).

**ZPST Bid-Ask Spread on the PFTS**



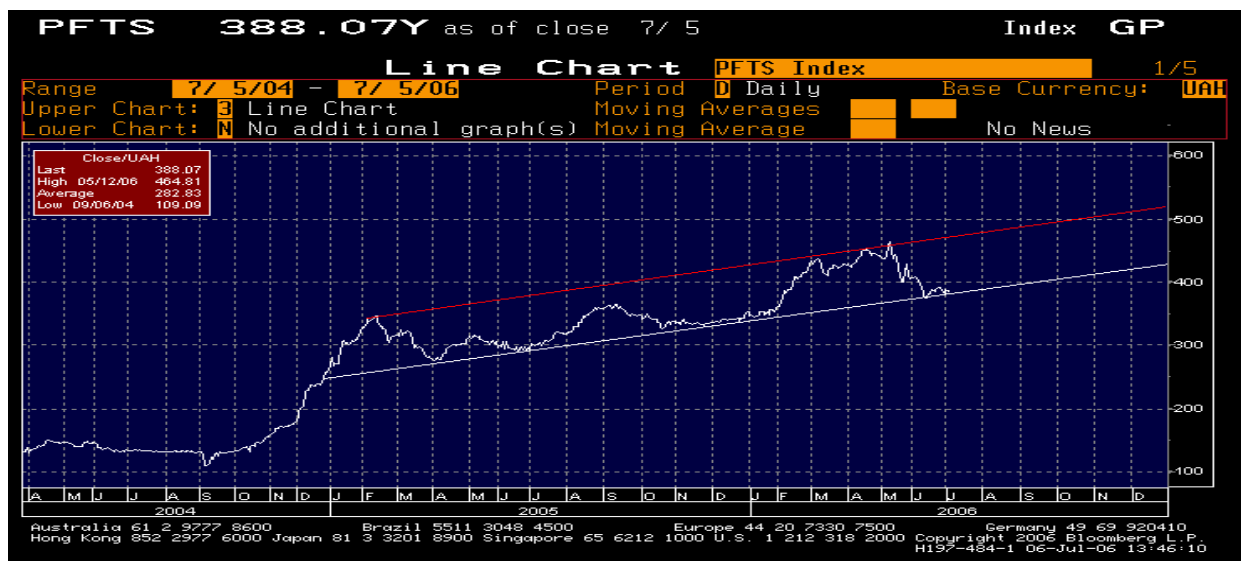
Source: PFTS; Concorde Capital calculations

However, in our opinion, there would be no point in permanently excluding ZPST from the index basket as that would not punish majority shareholders.

## PFTS to rally

The PFTS has a history of being shaken every now and then by blue chips testing minority shareholders' nerves with incidents of bad corporate governance. Just think of the most infamous cases - NITR and UNAF in the second half of 2004. The market has always recovered from those shocks relatively quickly.

We still remain bullish on the Ukrainian market, with our end-of-the-year PFTS index target of 535, implying a 51.5% annual growth rate. Our target is just above the upper end of the trading corridor indicated in the chart below. We think the rebound of global emerging markets and strength in the steel sector will support better performance in the second half of the year.



Source: Bloomberg

## Azovstal up next?

We are waiting for another announcement about the buy-out price for Azovstal today. AZST's minority shareholders were also diluted in the process of consolidation. However, the scope of the dilution is less than with ZPST. Depending on AZST's policy with regards to treasury stock, the dilution would be in the range of 8%-35% (please refer to Andriy Gostik's ANB of May 5, 2006 for details). AZST did not disrupt the market as it is not represented in the PFTS index and its spread increased less than ZPST's (to 20%). AZST belongs to System Capital Management which has re-positioned its companies as transparent businesses pursuing IPO plans. Thus, we are more positive on the outcome in AZST's case for minority shareholders.

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