

Prykarpatoblenergo

Most profitable Oblenergo to be privatized

August 2, 2010

Target price: UAH 6.7/USD 0.85

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The privatization of a 25% stake in Prykarpatoblenergo, Ukraine's most profitable electricity distribution company, is scheduled for August 17. We recommend participating in the auction for incremental blocks and suggest a bid ceiling of UAH 4.5 per share, which suggests 50% upside to our target price of UAH 6.7.

MARKET INFORMATION

| | |
|--------------------------|-----------|
| Bid/Ask , USD | 0.31/0.63 |
| 52 Wk H/L USD | 0.63/0.38 |
| Avg M Tr Vol 6M, USD mln | 0.02 |
| MCap* , USD mln | 58.6 |
| Free float | 12.3% |
| FF MCap, USD mln | 7.2 |

Ticker (UX, PFTS) PREN

No of shares, mln 103.6
 Par Value, UAH 0.25

* At UAH 4.48 per share, our bid ceiling price

MARKET MULTIPLES*

| | 2009 | 2010E | 2011E |
|----------------|------|-------|-------|
| EV/EBITDA | 4.2 | 4.9 | 3.7 |
| EV/RAB | | | 0.28 |
| EV/kWh transm. | 27.9 | 26.8 | 25.5 |

* At UAH 4.48 per share, our bid ceiling price

KEY FINANCIALS, USD mln

| | 2009 | 2010E | 2011E |
|--------------|------|-------|-------|
| Net revenues | 74.5 | 88.3 | 107.8 |
| EBITDA | 14.2 | 12.2 | 15.8 |
| EBITDA mgn | 19% | 14% | 15% |
| Net debt | 0.5 | 0.5 | 0.5 |

STOCK OWNERSHIP

| | |
|---------------------|-----|
| Surkis | 63% |
| State Property Fund | 25% |
| Other | 12% |

Sale via incremental blocks on August 17

On August 17, the State Property Fund will offer a 25% stake in Prykarpatoblenergo, likely in one percent increments. The starting price, which we expect to be low enough to allow 50% upside to our target price, should be announced on August 12.

Ukraine's most profitable electricity distributor

- Most profitable of 29 Ukrainian Oblenergos with a 2009 EBITDA margin of 19% vs. median of 10%
- Second highest commercial gain (derived from reduction in power loss during distribution) among distributors, resulting in UAH 24 mln in savings (20% of EBITDA) in 2009
- High share of household customers suggests higher LT output growth. From 2004-2009, household consumption increased at 7% CAGR compared to flat consumption for the country as a whole
- Conflict between major shareholders was resolved last December, with control now consolidated in the hands of Grigoriy Surkis
- Negotiated industry's second largest investment program (fully financed through tariffs) in 2010, or UAH 29 per kWh vs. median of UAH 18
- Major customer Lukor is expected to restart production in 2H10, which should increase demand by 15% yoy in 2H10-1H11

Defensive industry with reform to stimulate earnings growth

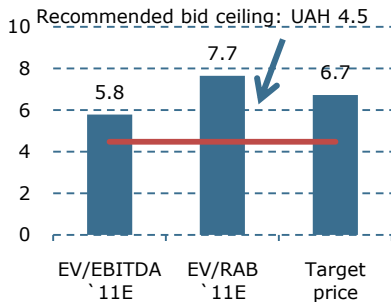
Migration to RAB regulation, which we anticipate in 2011-2014 as part of announced sector reforms, should boost distributor profitability sectorwide by 2-4 times, according to our estimates. Meanwhile, the current cost-plus tariff methodology guarantees profit at a specified level (median EBITDA margin of 10% in 2009).

Valuation and ceiling price for participating in auctions

Using multiples-based valuation, we derived a target price of UAH 6.7 implied by the Russian peer median 2011E EV/EBITDA of 4.8x and EV/RAB of 0.47x. Given inherent uncertainty regarding the privatization sale price, we recommend a bid ceiling of UAH 4.5 per share at the auction, assuming 50% required upside. We expect the SPF to set a starting price in the UAH 3.5-4.5 range, based on the results of the Poltavaoblenergo and Sumyoblenergo auctions in July (adjusted for relative size). Although PREN is traded, it is extremely illiquid (average monthly trading volumes over the last six months was USD 20 ths).

Multiples-based comparative valuation

Implied PREN prices, UAH per share



Source: Bloomberg, Concorde Capital

We calculated our target price for Prykarpatooblenergo as the average priced implied by the median 2011E EV/EBITDA of 4.8x and the 2011E EV/RAB of 0.47x for Russian peers. We rely on Russian peers as we believe anticipated reforms in Ukraine will mirror similar sweeping changes made in the Russian power sector in 2009-10.

While short-term value is captured by 2011E EV/EBITDA, we believe the fundamental value of distribution companies will be unlocked by the transition to RAB regulation, which we expect in 2011-2014 as part of a broader palette of reforms across the energy sector.

We conservatively estimate approved RAB value based on available 2006 data provided by the NERC, assuming no change in prices.

As in Russia, we expect NOPAT returns to be below the cost of capital. We assume the current median EV/RAB for Russian peers of 0.47 fairly estimates the discount that should be applied to RAB values for Oblenergos.

With the inherent uncertainty in privatization sale prices, we recommend setting a ceiling for bids. We believe 50% upside to our calculated target price is an adequate return given the slow pace of sector reform, which suggests a bid ceiling of UAH 4.5 per share.

Peer multiples

| | MCap | EV | EV/S | | EV/EBITDA | | EV/RAB | EV/Electricity | EV/lines |
|------------------------------|---------|---------|-------------|-------------|------------|------------|-------------|----------------|------------|
| | USD mln | USD mln | 2010E | 2011E | 2010E | 2011E | 2011E | USD per kWh | USD per m |
| PREN | 59* | 59* | 0.67* | 0.55* | 4.9* | 3.7* | 0.28* | 27.9* | 2.3* |
| Russian peers | | | | | | | | | |
| MOESK | 4,038 | 4,463 | 0.97 | 0.86 | 6.9 | 5.2 | 0.73 | 54.5 | 33.8 |
| MRSK of Center | 1,463 | 1,614 | 0.87 | 0.73 | 3.9 | 2.8 | 0.40 | 25.8 | 4.4 |
| MRSK of Siberia | 796 | 1,014 | 0.73 | 0.55 | 8.9 | 4.5 | 0.37 | 9.1 | 3.9 |
| Lenenergo | 676 | 1,616 | 1.74 | 1.61 | 5.7 | 5.9 | 0.61 | 50.0 | 30.5 |
| MRSK of Center and Volga | 755 | 1,206 | 0.87 | 0.72 | 8.2 | 5.3 | 0.47 | 19.7 | 4.8 |
| MRSK of Urals | 718 | 1,172 | 0.73 | 0.61 | 4.5 | 3.6 | 0.51 | 12.9 | 8.0 |
| MRSK of North-West | 651 | 806 | 0.85 | 0.74 | 6.5 | 5.4 | 0.48 | 17.7 | 4.8 |
| MRSK of Volga | 591 | 1,202 | 1.02 | 0.90 | 7.2 | 5.1 | 0.73 | 19.1 | 5.5 |
| MRSK of South | 274 | 701 | 1.09 | 0.88 | 5.4 | 4.1 | 0.42 | 13.3 | 4.5 |
| MRSK of North Caucasus | 135 | 203 | 0.56 | 0.48 | 5.5 | 3.5 | 0.15 | 11.8 | 1.5 |
| Mean | | | 0.94 | 0.81 | 6.2 | 4.5 | 0.49 | 23.4 | 10.2 |
| Median | | | 0.87 | 0.74 | 6.1 | 4.8 | 0.47 | 18.4 | 4.8 |
| PREN | | | | | | | | | |
| Implied price, USD per share | | | 0.74 | 0.76 | 0.71 | 0.73 | 0.97 | 0.37 | 1.19 |
| Implied price, UAH per share | | | 5.83 | 6.00 | 5.60 | 5.76 | 7.63 | 2.94 | 9.41 |
| Upside to starting price | | | 30% | 34% | 25% | 29% | 71% | -34% | 111% |

* At UAH 4.48 per share, our bid ceiling price

Source: Company data, NERC, Bloomberg, Concorde Capital

Key financial and operating data

| | Sales | | EBITDA | | Net debt | RAB | Electricity distributed | Grid length |
|------|---------|-------|---------|-------|----------|---------|-------------------------|-------------|
| | USD mln | | USD mln | | USD mln | USD mln | mln kWh | ths km |
| | 2010E | 2011E | 2010E | 2011E | 2010E | 2011E | | |
| PREN | 88 | 108 | 12 | 16 | 1 | 212 | 2,119 | 26 |

Russian peers

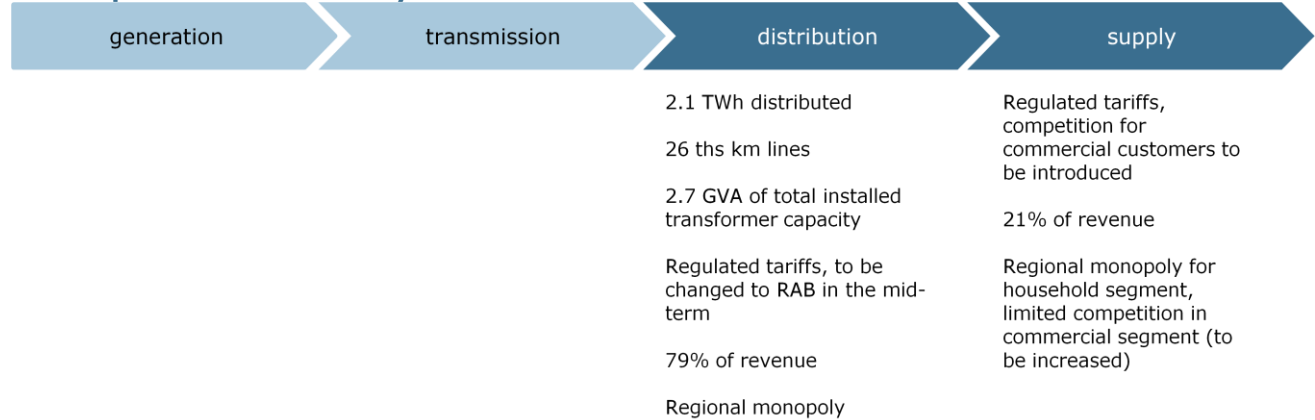
| | | | | | | | | |
|--------------------------|-------|-------|-----|-----|-----|-------|---------|-----|
| MOESK | 4,445 | 5,062 | 689 | 895 | 399 | 6,156 | 81,855 | 132 |
| MRSK of Center | 1,815 | 2,311 | 370 | 554 | 185 | 4,012 | 62,494 | 370 |
| MRSK of Siberia | 1,298 | 1,435 | 149 | 126 | 185 | 2,771 | 110,961 | 261 |
| Lenenergo | 824 | 912 | 236 | 235 | 712 | 2,671 | 32,354 | 53 |
| MRSK of Center and Volga | 1,662 | 2,108 | 203 | 311 | 539 | 2,581 | 61,122 | 253 |
| MRSK of Urals | 1,577 | 2,059 | 244 | 298 | 454 | 2,282 | 90,614 | 146 |
| MRSK of North-West | 910 | 1,119 | 118 | 159 | 155 | 1,676 | 45,499 | 169 |
| MRSK of Volga | 948 | 1,097 | 134 | 143 | 448 | 1,652 | 62,808 | 218 |
| MRSK of South | 572 | 679 | 117 | 154 | 384 | 1,673 | 52,607 | 156 |
| MRSK of North Caucasus | 361 | 431 | 33 | 51 | 102 | 1,321 | 17,206 | 136 |

Source: Company data, NERC, Bloomberg, Concorde Capital

Summary of PREN key operating indicators

| | Electricity distributed in 2009 | Grid length | Sub-station capacity | Estimated RAB | High-voltage customers | Low-voltage customers | Covered territory | Population of territory | Population density |
|--|---------------------------------|-------------|----------------------|---------------|------------------------|-----------------------|-------------------|-------------------------|--------------------|
| | mln kWh | ths km | MVA | USD mln | 2009 | 2009 | ths sq km | mln | person per sq km |
| | PREN | 2,119 | 26.0 | 2,747 | 212 | 23% | 77% | 13.9 | 1.4 |

Source: Company data, NERC

PREN's place in the electricity value chain


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