



# Reprivatization

## The show begins?

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**Alexnder Paraschiy**  
ap@concorde.com.ua**Inna Perepelytsya**  
pi@concorde.com.ua**Andriy Gerus**  
ga@concorde.com.ua

+380 44 391 5577

Yesterday, Yulia Tymoshenko nominated Andriy Portnov to head the State Property Fund of Ukraine (SPF). An experienced lawyer, Portnov is now tapped to fulfill Tymoshenko's campaign promises regarding reprivatization. The main cases in play are: Luhanskteplovoz (LTPL: U/R), Dniproenergo (DNEN: HOLD) and Nikopol Ferroalloy (NFER: U/R). We see little chance of an ownership changing at all three; we think one SPF victory would be enough politically. We remain quite positive on all stocks.

### Fulfilling campaign promises

Yulia Tymoshenko is set on making good on her pre-election vows, among the more notable of which was a review in the courts of what she labeled unfair privatizations. Tymoshenko is known for her dedication in fulfilling her promises (recall her successful crusade against shady schemes in metallurgy back in 2005). We doubt that the SPF will overturn all three cases – but one successful reprivatization is politically essential and quite realistic.

### The SPF's task is time-sensitive

Taking into account Portnov's experience in corporate law (he worked as a lawyer for Privat group – renowned for its corporate wars), he is definitely capable of finding legal grounding to reverse all three cases. However, a delay in appointing Portnov as Head of the SPF could make the task harder for Nikopol Ferroalloy (after February 7 it may be too late) and Dniproenergo (deadline is March 21). The Parliament still has to vote on the approval of Portnov's candidacy.

### What are the odds?

Noting the state's frustration in reprivatizing Nikopol Ferroalloy in 2005, this case looks a hard nut to crack. Dniproenergo's reprivatization requires strong political will, which we are unsure of at the moment. Luhanskteplovoz looks the easiest task to tackle from a legal point of view, though complicated by cross-border legal issues of returning a stake from the current Russian owner to the SPF. Overall, we see a long and bumpy road for Tymoshenko, with higher chances for some kind of success at Luhanskteplovoz.

### Our bet: "re-privatization" without changing ownership

While the current private owners at all three assets bring the highest value-generating potential due to multiple synergies, the most feasible way to resolve the issue is to resell these objects back to the same owner at higher prices.

### Impact on stock prices: mixed

Reprivatization jitters will most probably keep LTPL's stock price turbulent in the short-term. We stick to our opinion that Transmashholding will remain its owner in the long run, and consider this period of uncertainty as an opportunity to buy. Reprivatization, if any, is unlikely to have any noticeable impact on the price of NFER, but could push DNEN's price upward.

	Price	12M TP	Upside	Rec.
DNEN	498	516	4%	HOLD
LTPL	1.44	U/R	U/R	U/R
NFER	1.19	U/R	U/R	U/R

	MCap, USD mln	Free float %	Free float USD mln
DNEN	2,986.8*	5	149.0
LTPL	316.3	15	47.4
NFER	921.2*	2	18.4

\* assuming additional shares issue

### Key financials, USD mln, 9M07

	Sales	EBITDA	Net income
DNEN	494.6	55.5	13.9
LTPL	41.2	-3.1	-8.5
NFER	627.6	39.0	17.0

### Concorde Corp. Gov. Rating\*\*

DNEN	A
LTPL	BA
NFER	P

\*\*The rating is based on Concorde Capital's corporate governance survey. Q denotes quality corporate governance standards, AA - above average standards, A - average, BA - below average and P - poor.

	Stake under question	Privatization MCap	P/Sales*	Discount to market price**	Prob. of reprivatization
DNEN	29%	1,179	2.14	46%	Low/fair
LTPL	76%	76	0.87	34%	Fair
NFER	50%	160	0.56	n/a	Low

Source: PFTS, company data, Concorde Capital calculations

\*Privatization MCap to sales of previous year \*\* Discount to pre-announcement market price at PFTS

## Case 1: Dniproenergo

### What happened?

The additional share issue initiated by DTEK in August 2007 effectively increased DTEK's stake in Dniproenergo from 15.3% to 44.3%; stakes of all other shareholders were diluted by 1.52 times. On January 16, validity of the issue is scheduled to be considered by the High Economic Court.

### How hard is it to reprivatize?

We believe that strong political will is a necessary component of any successful initiative to reprivatize Dniproenergo. At the same time, we see that the President does not seem to support Tymoshenko on this issue: 1) he did not prevent the additional share issue in August 2007, though he had enough power to do so; 2) he appointed Raisa Bogatyryova (who is close to DTEK's owner Rinat Akhmetov) as the Secretary of the Council of Security and Defense - this position has enough power to complicate any reprivatization process. We estimate the chance for reprivatization as low.

### Timing

We do not expect any fast resolutions. We see the situation being clarified by March 21, the date of Dniproenergo's AGM, which is set to approve the results of the additional share issue.

### DTEK is likely to remain in control

We believe that DTEK better fits Dniproenergo than any other owner in terms of synergies, as it owns two coal mines that have historically been the main suppliers of coal for the company's power plants. We expect DTEK will participate and win a new privatization tender in the event of reprivatization. Thus, no impact on the company's value is expected in the mid-term.

### Immediate impact of "reprivatization" on market price: positive

Dniproenergo's current EV/Capacity multiple of 426 USD/kW (to hold also in case of reprivatization) implies an 11% premium to Ukrainian peers. This premium is deemed justified due to synergies inside DTEK holding. At the current market price, EV/Capacity would be 323 USD/kW (16% discount to Ukrainian peers) if the additional issue is nullified. Cancellation would become a catalyst to eliminate the 16% discount.

## Case 2: Luhanskteplovoz

### Courts ruled for reprivatization

On September 25, 2007 the Kyiv Appellate Court issued a verdict in favor of Dniprovahonmash, barring the sale of a 76% stake in Luhanskteplovoz to Bryansk Heavy Machinery (affiliate of Transmashholding, TMH). Last week, the Supreme Court of Ukraine declined to hear the State Property Fund's appeal against the Kyiv Appellate Court ruling.

### Transmashholding is not going to give its stake to the SPF

The management of TMH feels quite confident. Yesterday, in a conversation with us, TMH representatives confirmed that the holding's lawyers are seeking ways to leave the stake under the control of Bryansk Heavy Machinery. A strong point for TMH is that it is not registered in Ukraine, which additionally complicates returning the shares to the SPF.

### No one is likely to pay more for LTPL than TMH

We believe that Transmashholding will remain Luhanskteplovoz's owner, even in the event of reprivatization and a new privatization tender:

- The main consumer of LTPL, Russian Railways, controls 25% of TMH
- No Ukrainian and other international bidders can realize LTPL's potential without access to Russian market
- Luhanskteplovoz launched production of two new models of locomotives designed by TMH. Exit by TMH would cancel new projects
- TMH affiliates are suppliers of diesel engines to LTPL. A change in suppliers for LTPL means a minimum 30% increase in costs and is time-consuming (it will require new certification, which can take up to 18 months)

### "Careful" reprivatization

We believe that Tymoshenko could realize the reprivatization of LTPL only with an agreement with TMH, and only if TMH is guaranteed to remain the owner of LTPL after a new privatization. One of the possible scenarios is that TMH will pay up for the disputed stake (or raise its investment obligations) during a new privatization tender.

### Impact on stock price

We expect short-term price turbulence for LTPL due to uncertainty over the SPF's quest to reprivatize it. Based on our belief that TMH will retain ownership, reprivatization (if any) will have no effect on the long-term value of Luhanskteplovoz.

### Case 3: Nikopol Ferroalloy

#### **Tymoshenko is still for re-privatization but much more cautious**

On January 12, Yulia Tymoshenko announced that the government will study the possibility of reclaiming the disputed 50%+1 share stake in Nikopol Ferroalloy. Noticeably, her language was anything but passionate in contrast to her statements in 2005. She pointed out that the new head of the SPF will analyze all relevant court rulings, and stressed that the solution will be within the framework of the court decisions.

#### **SPF has a three-week window in which to act**

At their EGM on Nov. 22, 2007, shareholders in Nikopol Ferroalloy voted on a fivefold charter fund increase via an additional share issue. The issue dilutes the disputed stake from 50% to roughly 10%.

Subscription is underway, and the SPF is rather pressed for time to start legal actions before the results of the subscription are approved.

January 14-30, 2008:	Subscription to new share issue
<b>February 7, 2008:</b>	Approval of additional share issue at the EGM
Feb-Mar 2008:	Registration of the issue's placement by the State Securities and Stock Market Commission

#### **Privat & Interpipe are likely to retain control over the company**

We believe Privat and Interpipe will succeed in diluting the disputed stake to 10%, making reprivatization a waste of time:

- The times of quarrelling between Kolomoyskiy (Privat-Group) and Pinchuk (Concern Pridneprovye) over NFER have come to an end, after the two joined forces. Details of their agreement are not public, however Privat is known to have obtained operational control in the company and can successfully leverage its lobby in the pro-president parliamentary Our Ukraine – People Self Defence faction.
- Nikopol Ferroalloy was not among Tymoshenko's pre-election re-privatization promises, and the case would be not as painful to give up.

#### **Impact of re-privatization news on the stock market: neutral**

Any possible effects on the stock price are going to be muffled by the recent defensive market spread widening to 65%-70%, making trading rather difficult. This price pattern is a normal adjustment to the new share issue, the spread is expected to narrow to within a normal level in a couple months' time.

**Concorde Capital**  
**2 Mechnikova Street**  
**21st Floor**  
**Kyiv 01601, UKRAINE**

**Tel.: +380 44 391 5577**  
**Fax: +380 44 391 5571**  
**www.concorde.com.ua**  
**office@concorde.com.ua**

**CEO**

Igor Mazepa

im@concorde.com.ua

**Equity Trading**

Jathan Tucker

jt@concorde.com.ua

**Equity Sales**

Anastasiya Nazarenko

an@concorde.com.ua

Zack Watson

zw@concorde.com.ua

Duff Kovacs, CFA

dk@concorde.com.ua

Marina Martirosyan

mm@concorde.com.ua

**Director of Research**

Konstantin Fisun, CFA

kf@concorde.com.ua

**RESEARCH COVERAGE BY SECTOR**

**Strategy**

Konstantin Fisun

kf@concorde.com.ua

Oleksandr Klymchuk

ok@concorde.com.ua

**Metals & Mining**

Eugene Cherviachenko

ec@concorde.com.ua

Andriy Gerus

ga@concorde.com.ua

**Utilities (Telecom, Energy)**

Alexander Paraschiy

ap@concorde.com.ua

**Oil & Gas, Chemicals**

Vladimir Nesterenko

vn@concorde.com.ua

**Consumer/Real Estate Group**

Andriy Gostik, CFA

ag@concorde.com.ua

Olha Pankiv

op@concorde.com.ua

Alexander Romanov

ar@concorde.com.ua

Anna Dudchenko

ad@concorde.com.ua

**Machinery**

Eugene Cherviachenko

ec@concorde.com.ua

Inna Perepelytsya

pi@concorde.com.ua

**Financial Services, Retail**

Alexander Viktorov

av@concorde.com.ua

**Macroeconomics**

Polina Khomenko

pk@concorde.com.ua

**Fixed Income**

Oleksandr Klymchuk

ok@concorde.com.ua

**Corporate Governance**

Nick Piazza

np@concorde.com.ua

**News/Production**

Nick Piazza

np@concorde.com.ua

Polina Khomenko

pk@concorde.com.ua

**Editor**

Brad Wells

bw@concorde.com.ua

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