

Pivnichny Iron Ore

Centralny Iron Ore

Strong results expected for 3Q10, dividends in 2011

We recommend **Pivnichny Iron Ore (SGOK)** and **Centralny Iron Ore (CGOK)**, both part of Metinvest, as **BUYS**, given the strong financial results anticipated for 9M10 as well as the hefty dividend payments expected in 1H11.

After exceptional iron ore price growth of 40%-60% in 2Q10, prices fell slightly in the third quarter: average domestic iron ore prices decreased by 3% q-o-q to USD 114/mt while pellets dropped by 16% q-o-q to USD106 (for more details see Appendix 2). Based on price dynamics, we estimate that SGOK's EBITDA for 9M10 should reach UAH 4,375 mln (USD575 mln), a 167% increase y-o-y, and we expect net income of UAH 2,518 (USD318 mln).

We anticipate CGOK's 9M10 net income should reach UAH 1.0 bln (USD135 mln), up 8.1x y-o-y, and EBITDA should be UAH 1,625 (USD205 mln).

We have positive outlook for fourth quarter earnings as parent Metinvest announced that both companies will increase their iron ore and pellet prices by 10% q-o-q. In addition, we expect SGOK and CGOK to increase their output by 6-7% q-o-q due to forecasted increasing demand from Ukrainian steel companies in the fourth quarter. After Metinvest's recent acquisition of Ukraine's fourth largest steel producer, Mariupol Illich Steel, the companies will be assured of another stable customer.

We forecast Pivnichny Iron Ore and Centralny Iron Ore FY2010 net income will be UAH 3,516 mln (USD444 mln) or UAH 1.5 (USD0.19) per share and UAH 1,441 mln (USD182 mln) or UAH 1.25 (USD0.16) per share respectively. In addition Pivnichny Iron Ore and Centralny Iron Ore have retained earnings from previous years of UAH 1,062 mln (USD134 mln) and UAH 531 mln (USD67 mln) respectively, which also may be distributed as dividends in 2011.

The stocks gained 200%-300% between December 2009 and March 2010 on expectations of a 2009 earnings distribution via dividends, which were voted at AGM on March 31. We expect another rally of 40%-80% at the end of 2010 – beginning of 2011 ahead of both companies' AGMs, when shareholders are likely to continue the historical pattern of income distribution and pay out 100% of estimated 2010 net income.

Stock performance prior to last dividends payment, USD



Source: Bloomberg

Report date	21 Oct 2010
Bloomberg	SGOK UK

Recommendation	BUY
Price (20 Oct 10), USD	1.3
12M price target, USD	1.9

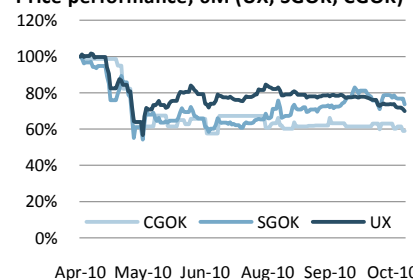
No of shares, mln	2304.1
Market Cap, USD mln	3,053.38
52-week performance	68%
52-week range, USD	0.39/2.12
ADT, 12M, USD mln	0.12
Free float, %	0.6%
Free float, USD mln	18.3

Report date	21 Oct 2010
Bloomberg	CGOK UK

Recommendation	BUY
Price (19 Oct 10), USD	0.60
12M price target, USD	1.28

No of shares, mln	1171.8
Market Cap, USD mln	706.94
52-week performance	185%
52-week range, USD	0.35/1.23
ADT, 12M, USD mln	0.007
Free float, %	0.7%
Free float, USD mln	4.9

Price performance, 6M (UX, SGOK, CGOK)



Source: Bloomberg, UX

Appendix 1: Peer valuation and financial projections

	MCap USDmln	EV/S		EV/EBITDA		P/E	
		10E	11E	10E	11E	10E	11E
UKRAINE							
Centralny Iron Ore	708.0	1.2	1.1	2.2	2.1	3.9	3.7
Pivnichny Iron Ore	2,991	2.3	2.0	3.6	3.2	6.7	5.8
DEVELOPED MARKETS							
BHP BILLITON PLC	209,434	2.8	2.6	5.1	4.8	9.4	9.7
VALE DO RIO DOCE	163,251	2.8	2.5	4.6	3.9	7.2	6.5
RIO TINTO PLC	144,211	2.4	2.2	5.0	4.6	9.0	9.0
ANGLO AMERICAN PLC	58,621	2.0	1.7	4.7	4.0	8.7	7.6
FERREXPO	3,138	2.5	2.3	5.3	4.9	6.8	6.8
Average		2.5	2.3	4.9	4.4	8.2	7.9
Median		2.5	2.3	5.0	4.6	8.7	7.6
CGOK price							
Implied by developed peers avg., USD/share		1.2	1.3	1.3	1.3	1.3	1.2
Upside/Downside to Developed med		92%	104%	113%	103%	113%	97%
SGOK price							
Implied by developed peers avg., USD/share		1.5	1.5	1.8	1.9	1.7	1.7
Upside/Downside to Developed med		13%	18%	38%	45%	28%	31%

Sources: Bloomberg, Concorde Capital

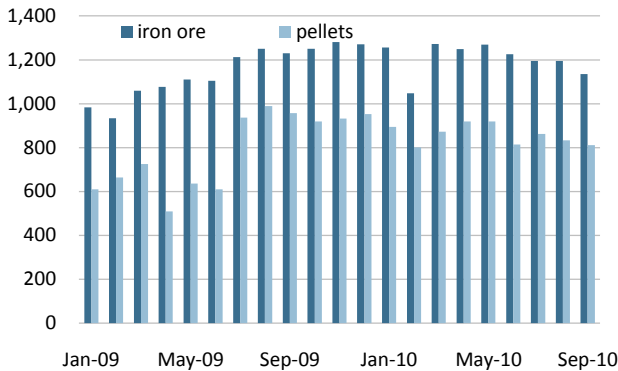
Pivnichny Iron Ore

in USD mln	2009	2010E	2011E
Sales	844	1,302	1,515
EBITDA	322	805	930
margin, %	38.2%	62%	61%
Net income	164	444	513
margin, %	19.4%	34%	34.0%

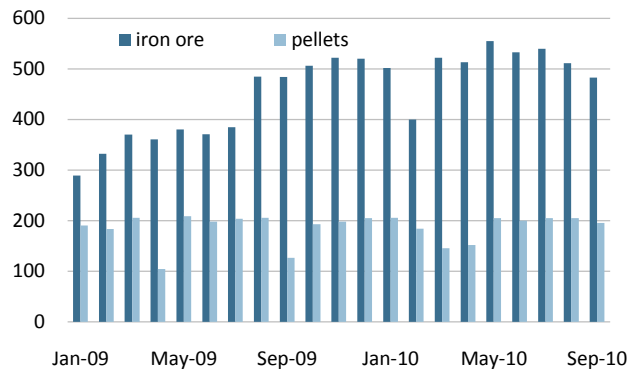
Centralny Iron Ore

in USD mln	2009	2010E	2011E
Sales	285	542	640
EBITDA	102	305	320
margin, %	36%	56%	50%
Net income	31	182	191
margin, %	12%	34%	30%

Appendix 2: Output volumes and prices

SGOK monthly production, ths. mt.


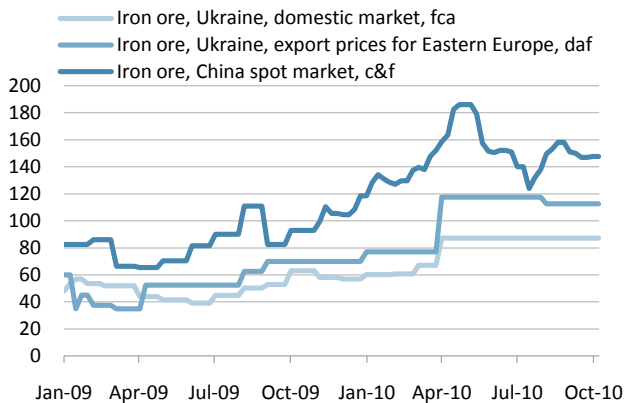
Source: Metal Expert

CGOK monthly production, ths. mt.


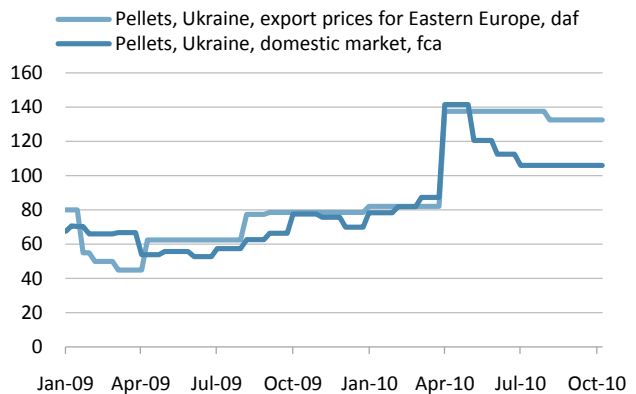
Source: Metal Expert

Notes:

- Pivnichny Iron Ore increased production of iron ore concentrate by 8.9% y-o-y to 10.8 mln mt and pellets by 16.4% y-o-y to 7.7 mln mt in 9M2010
- Centralny Iron Ore increased production of iron ore concentrate by 31.9% y-o-y to 4.6 mln mt and pellets by 4.4% y-o-y to 1.7 mln mt in 9M2010
- Pivnichny Iron Ore plans to increase capacity of iron ore concentrate production by 750 ths mt (5%) to 15.7 mln per year (1.31 mln per month) in 2011 and consider further increase of capacity by 2 mln mt per year
- Pivnichny Iron Ore plans to expand capacity of pellets output by 2 mln mt in IVQ2010 and by another 0.2 mln mt in III-IVQ2011 (total growth 18.3%) to 14.2 mln per year (1.18 mln mt per month)
- Pivnichny Iron Ore plans to increase quality of iron ore concentrate to Fe 66% (current price premium of 40-50 USD (25%-30%) over Fe 64%)

Iron ore prices, USD/mt


Source: Metal Expert

Pellets prices, USD/mt


Source: Metal Expert

Notes:

- Metinvest announced its plans to increase pellets prices in 3Q up 8.5%-15% to USD 115-122/mt
- We forecast 3Q domestic prices for iron ore of USD 115/mt (up 8.5% q-o-q)
- In October 2009, Metinvest launched deliveries to China. We expect it will increase such deliveries in 2011 due to substantial net price premium in China of USD30 mt (30%-35%) over local market (total premium USD60-70/mt, transportation cost USD30-40)
- All domestic prices are set in USD (actual payments are made in UAH at current USD/UAH rate)

Disclosures

Analyst certification

I, Andriy Gerus, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

SGOK ratings history

Date	12M target price, USD	Market price, USD	Rating	Action
27-May-05	0.9		BUY	Initiate
23-Nov-06	0.14	1.19	BUY	Maintain
14-Mar-08	0.14	3.19	SELL	Downgrade
9-Jul-08	2.23	1.8	HOLD	Upgrade
12-Feb-10	1.3	0.71	BUY	Upgrade
1-Jun-10	1.92	1.16	BUY	Maintain
1-Sep-10	1.92	1.28	BUY	Maintain

Source: Bloomberg, Concorde Capital

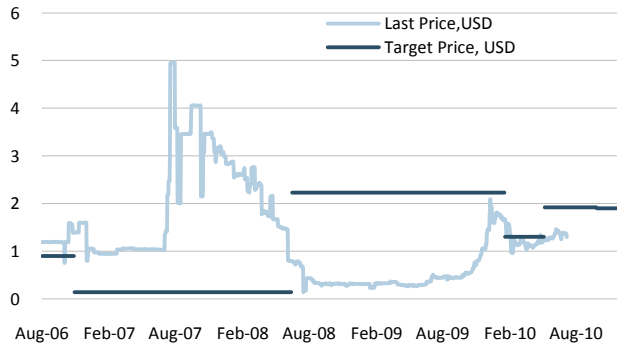
CGOK ratings history

Date	12M target price, USD	Market price, USD	Rating	Action
27-May-05	1		BUY	Initiate
23-Nov-06	0.14	0.79	BUY	Maintain
14-Mar-08	0.14	2.19	SELL	Downgrade
9-Jul-08	1.74	1.2	BUY	Upgrade
12-Feb-10	1.74	0.53	BUY	Maintain
1-Jun-10	1.28	0.69	BUY	Maintain
1-Sep-10	1.28	0.64	BUY	Maintain

Source: Bloomberg, Concorde Capital

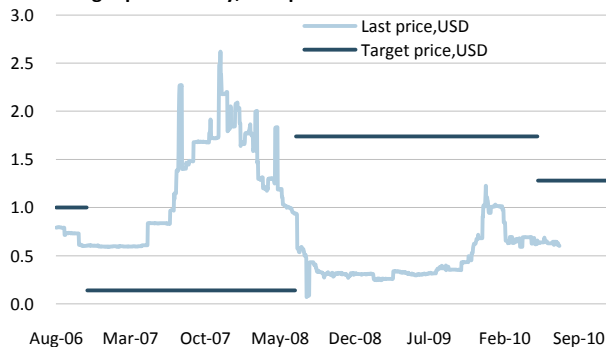
Note: In July 2009, Andriy Gerus took over coverage; prior to that point, it was covered by other Concorde analysts.

SGOK target price history, USD per share



Source: Bloomberg, Concorde Capital

CGOK target price history, USD per share



Source: Bloomberg, Concorde Capital

Investment ratings

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