

Ukrainian Railcar Producers

Only casting's the limit



June 1, 2012

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INVESTMENT CASE

We initiate coverage of two Ukrainian railcar producers, Stakhaniv Wagon and Kryukiv Wagon, with BUY recommendations and implied close to triple-digits upsides. The two manufacturers, in our view, are among the cream of Ukraine's investable universe, thanks to sustainable growth in output and financials. Even though wagon production is peaking and their mid-term growth prospects look more risky, we believe the companies do not deserve a 60% discount on EV/EBITDA to global peers. Among the two, Stakhaniv Wagon is the preferred short-term pick due to its focus on the booming gondola car market, while Kryukiv Wagon is a better mid-term play due to its prospects for capitalizing on potential domestic demand for high value-added passenger and subway wagons.

In the right place at the right time

Protected by external competition thanks to the CIS' unique 1,520 mm gauge, CIS railcar manufacturers are seeing record high demand driven by replacements of aging railcars. Robust pent-up demand accumulated in the 90s has allowed them to work over full capacity and post all-time high sales and earnings.

Bogie casting parts: The fly in the ointment

CIS railcar producers, able to sell everything they produce (and more), are not competing for customers. Their only bottleneck is a deficit of the key railcar component, bogie casting, which limits both output and profitability due to inflated prices. Stakhaniv Wagon, the only actively traded Ukrainian railcar maker self-sufficient in casting supplies, is best positioned to benefit from all-time high demand for freight railcars in the CIS.

More demand for specialized wagons in the mid-term

Our analysis shows that half of the current demand for freight railcars in the CIS is the working off of pent-up demand from the 90s, which will peak in 2013 and fade thereafter. Consumption will also shift from multi-purpose gondolas to specialized high value-added railcars. Though demand for gondolas is expected to drop 40% by 2015, which will naturally hit output volumes and revenues, the switch to fewer but specialized cars and drop in casting prices will positively affect companies' profitability. Both railcar producers possess broad freight wagon product range and look ready for the challenge. Kryukiv Wagon looks a better off in the mid-term as it is the only one capable of manufacturing subway and passenger wagons.

Recovery of domestic demand will be an additional sweetener

A boost in new freight car orders from local operators after Ukrzalizytsya is reformed will become an additional revenue driver for both companies; Kryukiv Wagon is already enjoying its first 1,000 freight car order from the state operator. The expansion of the Kyiv city subway system and the ongoing renovation of passenger wagons in Ukraine and Kazakhstan are additional long-term growth drivers for Kryukiv Wagon beyond the freight segment.

Key risk: restricted access to the Russian market

The increase in Russian railcar and casting production capacity will ease the dependence of domestic Russian freighters on supplies from Ukraine. Well known for its protectionism, Russia is likely to limit competition by restricting the use Ukraine-made bogie casting, the key wagon component. Stakhaniv Wagon, which has diversified supplies of bogie casting, is less sensitive to that risk.

Investment summary

| | Price, USD | MCap, USD mln | Sales, USD mln | | EBITDA margin | | EV/EBITDA | | 12M target, | | Rec. |
|-----------------|------------|------------------|----------------|-------|---------------|-------|-----------|-------|-------------|--------|------|
| | | | 2011 | 2012E | 2011 | 2012E | 2011 | 2012E | USD | Upside | |
| | | | | | | | | | | | |
| Kryukiv Wagon | 2.10 | 241 | 770 | 844 | 15.3% | 15.1% | 1.8x | 1.5x | 5.03 | 139% | BUY |
| Stakhaniv Wagon | 0.38 | 87 | 436 | 478 | 7.6% | 7.7% | 2.7x | 2.0x | 0.74 | 93% | BUY |
| Peer mean | | | | | 8% | 11% | 6.9x | 4.7x | | | |

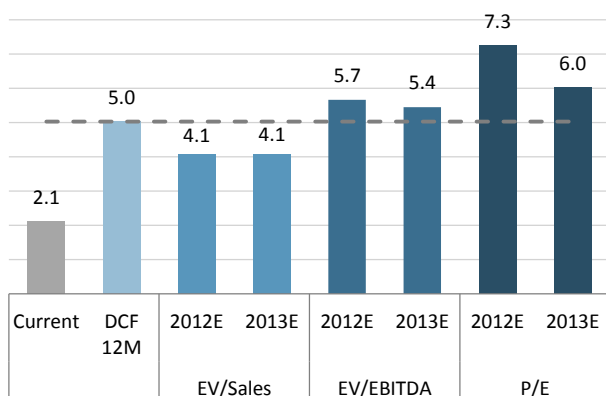
Source: Bloomberg, Concorde Capital

Valuation summary

We set our 12M target prices for both wagon producers based on DCF valuation. We note that DCF-implied prices are smaller than those implied by peer multiples, mainly due to higher country and company-specific risks than we account for in the model.

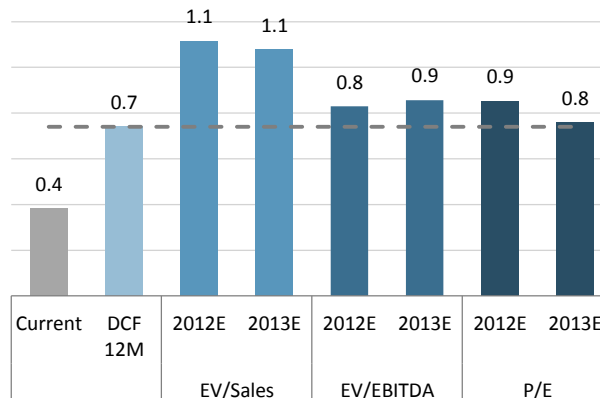
Our 12M target is USD 5.0/share for Kryukiv Wagon (implied upside is 139%) and USD 0.74/share for Stakhaniv Wagon (implied upside is 93%). We initiate coverage of both wagon makers with BUY recommendations.

Kryukiv Wagon implied share price



Source: Bloomberg, Concorde Capital

Stakhaniv Wagon implied share price



Source: Bloomberg, Concorde Capital

Peer comparison summary

| Company | Country | MCap USD mln | EV/Sales | | EV/EBITDA | | P/E | |
|----------------------------------|-----------|-----------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | 2012E | 2013E | 2012E | 2013E | 2012E | 2013E |
| Greenbrier Cos Inc | USA | 366 | 0.4x | 0.4x | 5.1x | 4.2x | 4.8x | 3.7x |
| Trinity Industries Inc | USA | 1,950 | 1.2x | 1.1x | 6.1x | 5.7x | 8.8x | 7.0x |
| American Railcar Ind | USA | 443 | 0.6x | 0.6x | 3.5x | 3.2x | 9.8x | 8.6x |
| Kawasaki Heavy Ind | Japan | 4,445 | 0.5x | 0.5x | 6.3x | 5.9x | 15.0x | 9.7x |
| Vossloh AG | Germany | 1,105 | 0.9x | 0.8x | 7.5x | 6.7x | 14.5x | 12.1x |
| Caf | Spain | 1,497 | 0.6x | 0.6x | 5.0x | 4.8x | 7.5x | 7.1x |
| Bradken Ltd | Australia | 986 | 0.9x | 0.8x | 5.8x | 4.6x | 10.3x | 7.7x |
| Bombardier Inc | Canada | 6,511 | 0.4x | 0.4x | 4.7x | 4.3x | 8.0x | 7.5x |
| FreightCar America Inc | USA | 237 | 0.2x | 0.2x | 2.6x | 3.0x | 9.4x | 10.0x |
| Peer harmonic mean | | | 0.5x | 0.5x | 4.7x | 4.4x | 8.8x | 7.4x |
| Kryukiv Wagon | Ukraine | 241 | 0.2x | 0.2x | 1.5x | 1.3x | 2.6x | 2.6x |
| Stakhaniv Wagon | Ukraine | 87 | 0.2x | 0.1x | 2.0x | 1.6x | 4.0x | 3.7x |
| <i>Discount to harmonic mean</i> | | | | | | | | |
| Kryukiv Wagon | | | (53%) | (57%) | (68%) | (69%) | (71%) | (65%) |
| Stakhaniv Wagon | | | (70%) | (72%) | (58%) | (64%) | (55%) | (49%) |

Source: Bloomberg, Concorde Capital

Defining our coverage universe

While there are five locally-listed Ukrainian railcar manufacturers, this report focuses on only two, Kryukiv Wagon and Stakhaniv Wagon. The others are off our radar for the following reasons:

- Azovmash-related stocks, Mariupol Heavy Machinery (MZVM UK) and Azovzahalmash (AZGM UK) – due to extremely low liquidity and high corporate governance risk. The latter stems from the fact that both legal entities are located at one production workshop, and have the same shareholder who is free to allocate sales, costs and debts at his own discretion.
- Dniprovahonmash (DNVM UK) – as it is an illiquid stock with free float of below 1%.

Wagon stock universe summary

| Company | Ticker | MCap, USD mln | Free float, % | Avg. daily turnover, YTD, USD ths |
|--------------------------|--------|---------------|---------------|-----------------------------------|
| Stakhaniv Wagon | SVGZ | 86.8 | 7.8% | 17.9 |
| Kryukiv Wagon | KVBZ | 241.3 | 4.7% | 12.9 |
| Azovzahalmash | AZGM | 6.04 | 3.5% | 1.6 |
| Mariupol Heavy Machinery | MZVM | 3.35 | 1.0% | 1.4 |
| Dniprovahonmash | DNVM | 103.64 | 0.7% | 0.9 |

Source: Company data, UX, Concorde Capital

CIS WAGON MARKET SNAPSHOT

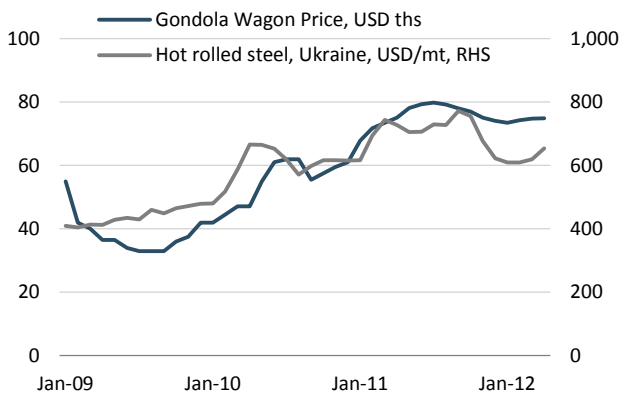
Railcars: more than just commodities

While freight railcars are usually considered simple commodities (due to their uncomplicated structure and dependence on commodity cycles), the railcar manufacturing business in the CIS is slightly different:

- there are high entry barriers due to a lack of manufacturing technology and skilled workforce
- there still exists large structural demand for new units (pent up demand due to low production in the 1990s and early 2000s), which mitigates some of the vulnerability to commodity cycles

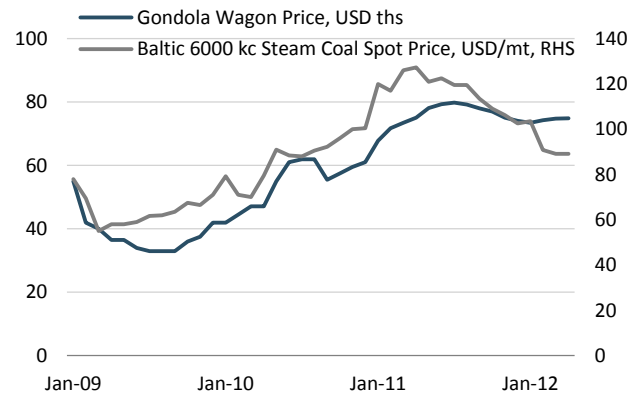
Due to these peculiarities, demand and prices for freight railcars typically do not perfectly correlate to commodities. In particular, due to high pent up demand to replace railcars in the CIS, wagon prices remain to the upside even when the price of other major commodities declines.

CIS prices of wagons (gondola), steel



Source: Metal-Courier, PG-online, Concorde Capital

CIS prices of wagons (gondola), coal

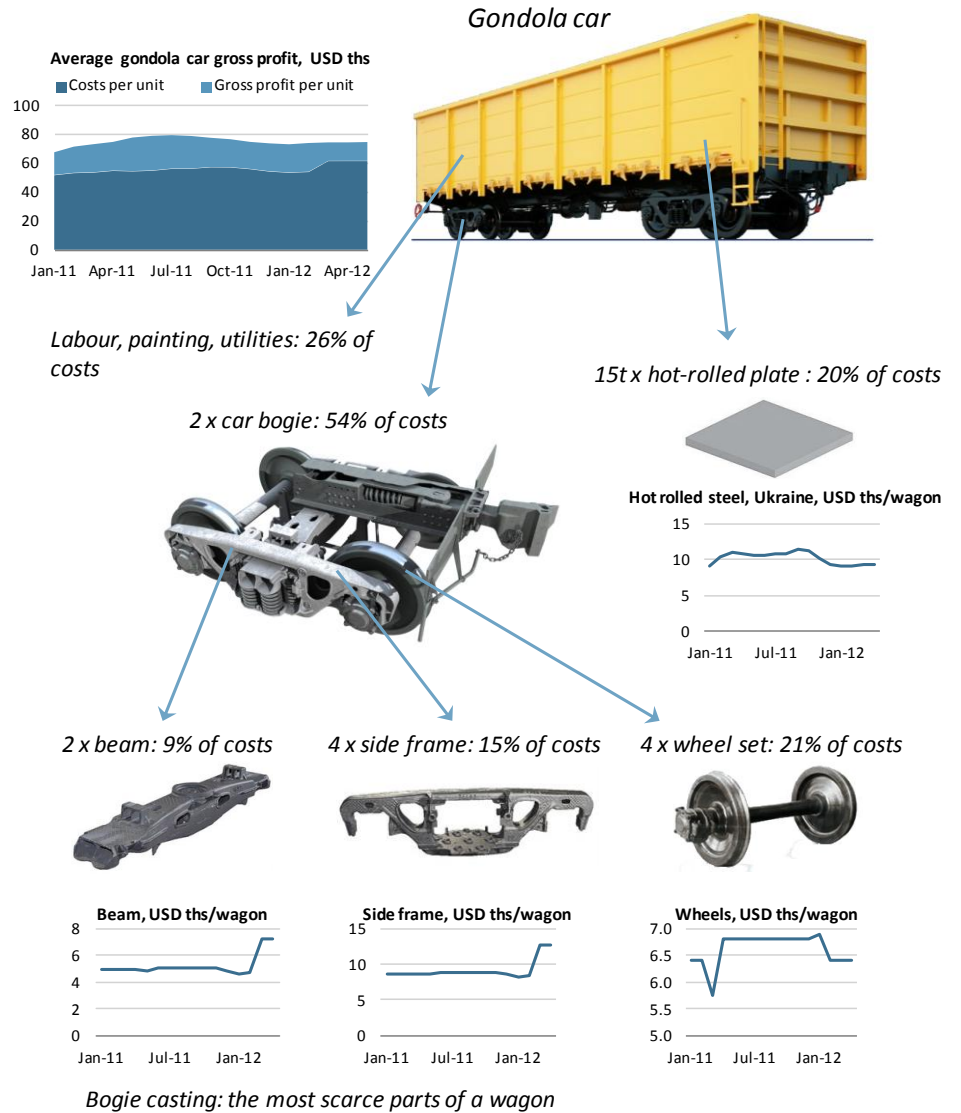


Source: Bloomberg, PG-online, Concorde Capital

70% of wagon costs are commodities

The two key components of gondola railcars, the body and bogie, account for more than 70% of production costs. While currently there is not a deficit for steel plates in the CIS, for bogie components – the casting beam and side frame – demand has been outstripping supply. In fact, supplies of these two parts determine a CIS wagon manufacturer’s short-term output capability and even profit.

Key raw materials for railcar production



Source: Metal-Courier, PG-online, Concorde Capital

CIS wagon industry at glance

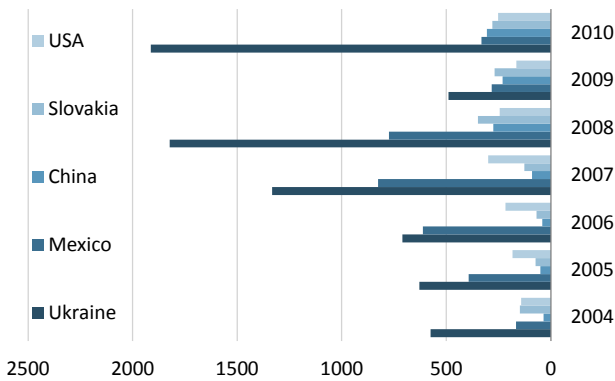
1520 mm gauge: the market with high entry barriers

The 1,520 mm railway track gauge, unique throughout the Former Soviet Union and Mongolia, is responsible for a railway equipment market with high barriers of entry that is in fact, isolated.

Ukraine accounts for half of global wagon cross-border supplies

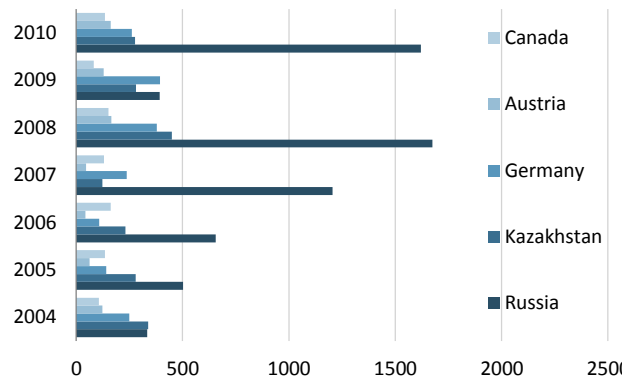
While a significant part of CIS wagon production is located in Ukraine, more than 90% of CIS wagon demand is from Russia. Due to this discrepancy in the location of production facilities and demand, Ukraine is the world's largest railcar exporter (50% of global wagon cross-border trade in 2010) while Russia is the largest railcar importer. Freight wagons made up 5% of Ukraine's total goods export in 2011 (USD 3.3 bln), making it the fifth largest export item after metals & ores, agricultural products, fuels and electric equipment.

Top five freight railcar exporters, USD mln



Source: UN COMTRADE statistics

Top five freight railcar importers, USD mln

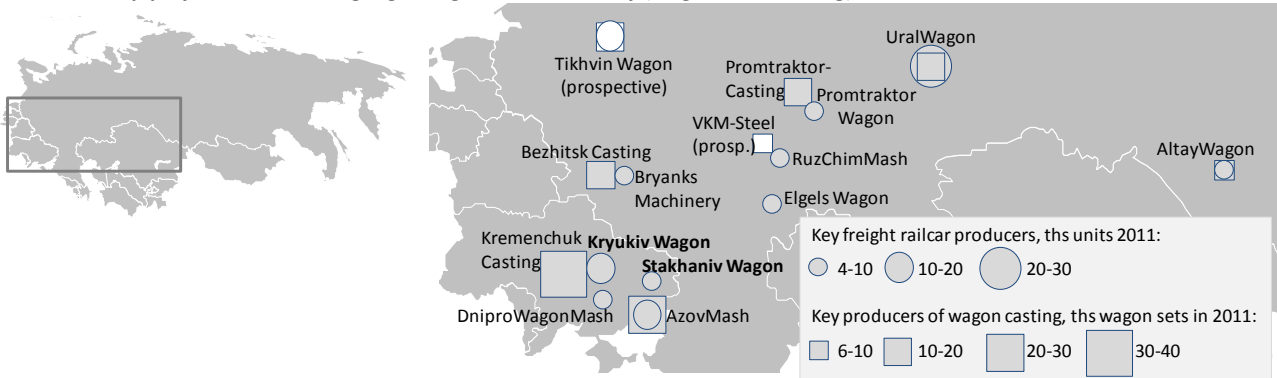


Source: UN COMTRADE statistics

Ukraine on the 1520 map: 40% of freight cars, 50% of wagon casting supplies

Ukraine is an integral part of the 1520 mm gauge freight railcar industry, accounting for more than 40% of total CIS freight railcar output, and for more than 50% of wagon casting parts output. Four out of the ten largest CIS railcar producers are located in Ukraine.

Location of top players in 1520 mm gauge freight railcar industry (wagons and casting)

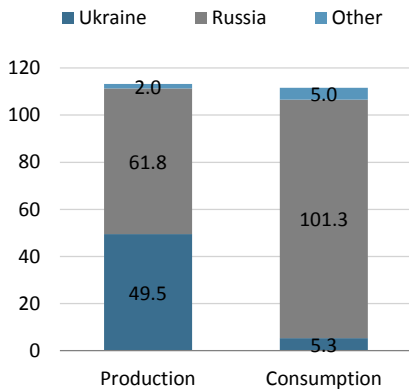


Source: Concorde Capital

Ukraine and Russia: mutual but not symmetric dependence

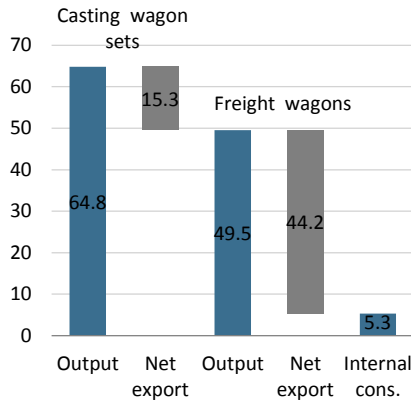
The isolation of the CIS' 1520 mm gauge railway system places Ukrainian railcar producers and Russian consumers in a mutually dependent situation. But the dependence of Russian consumers on Ukrainian supplies is much less than the dependence of Ukrainian producers on Russian demand.

CIS freight wagon balance 2011, ths units



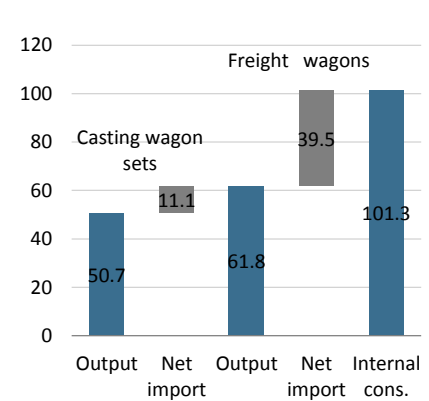
Source: PG-online, RZD, Concorde Capital

Ukraine's wagon chain 2011, ths units



Source: PG-online, Ukrstat, Concorde Capital

Russia's wagon chain 2011, ths units

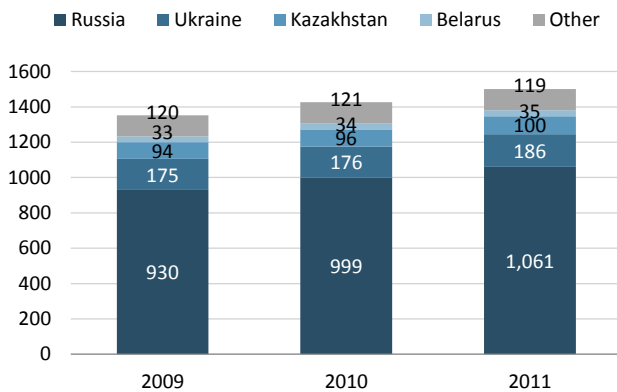


Source: PG-online, Rosstat, Concorde Capital

Russian dominance of CIS/1520 demand will persist

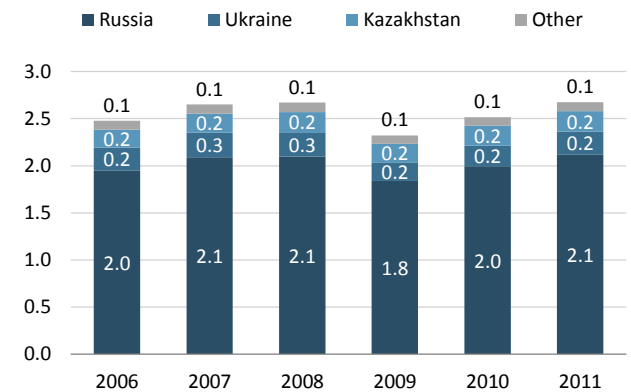
Russia will continue to be responsible for the lion's share of railcar demand because it has the largest wagon fleet: Russian operators own 70% of total CIS freight railcars and Russia accounts for 79% of total CIS freight rail turnover.

CIS freight railcars, ths units



Source: CIS statistic agencies, PG-online, Concorde Capital

CIS freight rail turnover, trillion tkm

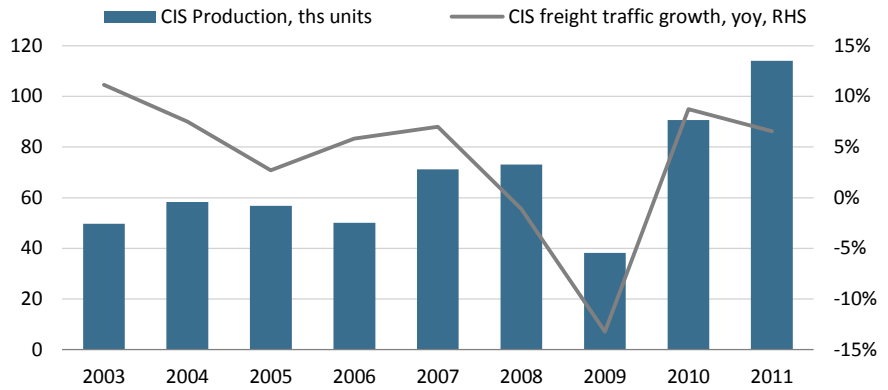


Source: CIS statistic agencies, Concorde Capital

Raw materials define CIS traffic growth and wagon demand

The economies in the CIS are based on the export of raw materials and semi-finished goods. This means that the recovery of basic materials production should result in an appreciable increase in freight traffic. According to CIS statistic agencies, as the freight traffic has been gradually recovering to pre-downturn levels, overall CIS freight rail turnover in 2011 reached 2,650 bln tons-km exceeding the levels of 2009 and 2010 by 15.9% and 6.6% respectively, and the pre-downturn level of 2008 by 0.5%.

CIS freight traffic growth vs. wagons output

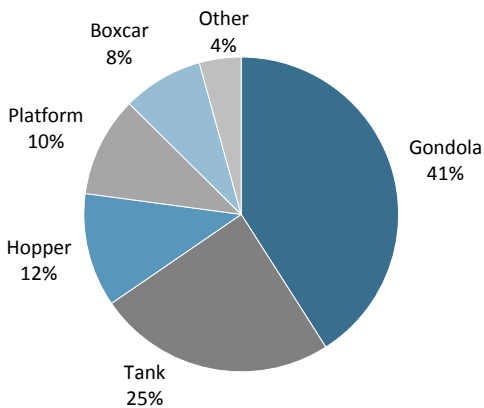


Freight rail turnover is a measure of freight carriage activity over a particular period calculated as the sum of tonnage of each loaded trip multiplied by the distance of each loaded trip.
Source: PG-online, CIS statistic agencies, Concorde Capital

Gondolas: the most in demand railcar

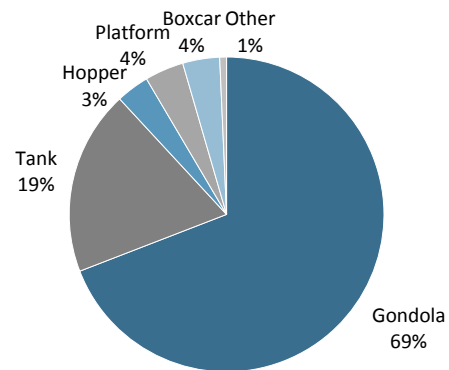
Most CIS railcar producers are focused on the production of gondola railcars, the hottest item currently. The spike in demand for transporting raw materials (coal, ore, steel) has been the main driver. As of end-2011, the share of gondola wagons in aggregate CIS output reached 69%, which was 1.7x more than its respective share in the CIS wagon fleet.

CIS freight railcar fleet structure, 2011



Source: PG-online, Concorde Capital

CIS freight railcar demand structure, 2011



Source: PG-online, Concorde Capital

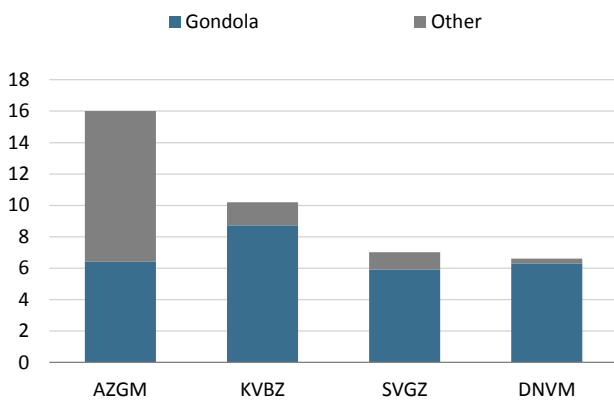
**MARKET IN 2012: YOU CAN SELL IT ALL (IF)
YOU CAN PRODUCE IT**

Summary: Gondolas and own casting are the key

Our analysis of short-term trends in the CIS wagon market suggests the following important implications for covered railcar producers:

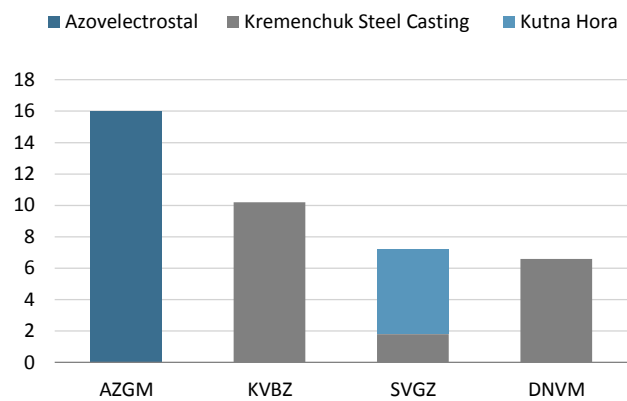
- Demand for freight railcars will exceed the supply capabilities of CIS producers in 2012
- Prices for gondola cars will remain strong in 2012-2013. Stakhaniv Wagon, the company most focused on gondolas, will be the key short-term winner
- The persisting deficit of bogie casting parts in the CIS will remain the key output-limiting factor – those able to secure supplies will be able to fully benefit from booming railcar demand. In addition, the scarcity of bogie casting will continue to inflate its prices, which will be the main factor limiting wagon producers’ profitability growth in 2012
- Diversification of bogie casting supplies is important for the mitigation of the risk of possible suspensions of individual casting producers’ certificates in the Russian market. From this perspective, Kryukiv Wagon, located just over the fence from the CIS’ largest casting supplier, Kremenchuk Steel Casting (and 100% dependent on it) is most vulnerable. Stakhaniv, again, looks most favorably positioned, as it currently has an alternative of buying casting from related Czech producer Kutna Hora.

Share of gondola cars in 2012E output, ths units



Source: Concorde Capital

Sources of bogie casting supplies in 2012E, ths wagon sets



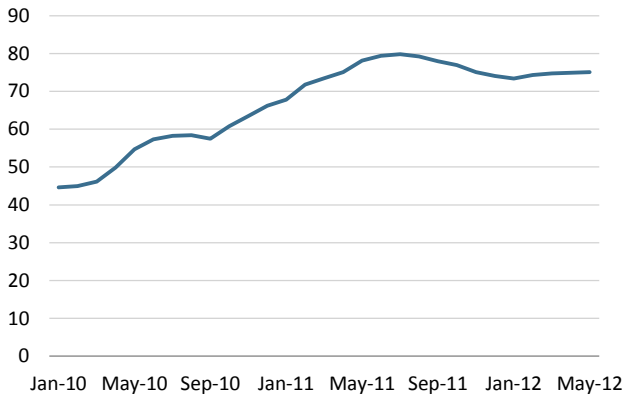
Source: Concorde Capital

Record-high demand is here to stay

The need to replace worn out railcars and growth in freight traffic in the CIS have caused a sharp increase in demand for new units in the region in the last few years. Demand has exceeded the available capacity of CIS railcar builders, and foreign producers have not been able to step in due to the tough entry barriers.

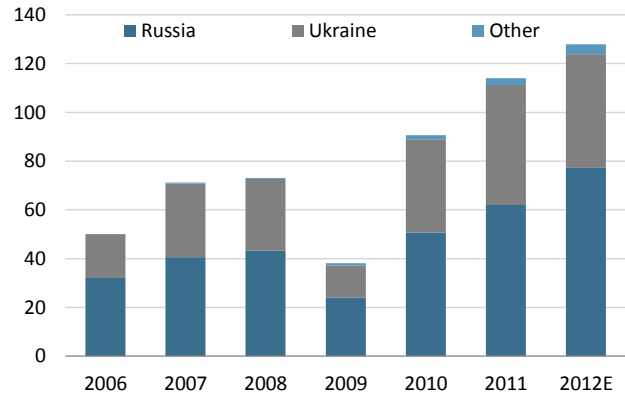
As a result of the deficit, the average freight railcar price in the CIS grew 35% yoy and total output reached an all-time high of 115,000 units in 2011.

Gondola car prices in the CIS, USD ths



Source: PG-online, Concorde Capital

CIS railcar output, 2006-2011



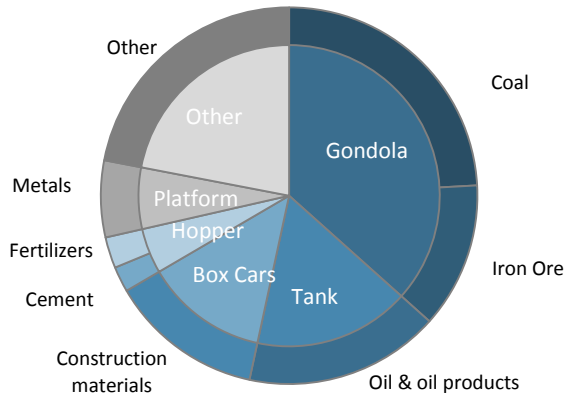
Source: CIS statistic agencies, PG-online, Concorde Capital

We estimate total potential CIS freight railcar demand to exceed supply by 8-10% and reach 135,000 units in 2012 (up 18% yoy compared to actual output in 2011). Limited railcar supplies due to the casting deficit and estimated 4% yoy growth in overall Russian freight rail turnover will support wagon prices at the current level (USD 75 ths for gondolas) in 2012.

Gondolas will continue to dominate

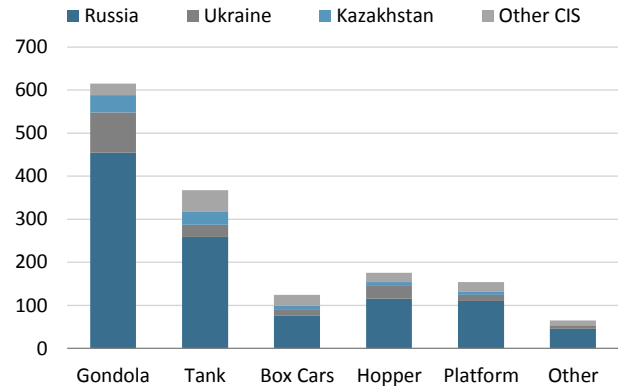
Coal, oil and iron ore made up 53% of total CIS cargo transported by rail in 2011 and we expect this mix to persist in 2012-2013. Therefore, gondola and tank railcars should remain the most popular type of freight railcar in the CIS. Notably, due to its universality, gondola cars remain the most popular type of wagon in CIS region.

CIS freight traffic by type of wagon and cargo, 2011



Source: CIS statistic agencies, Concorde Capital

CIS freight railcar fleet distribution, 2011



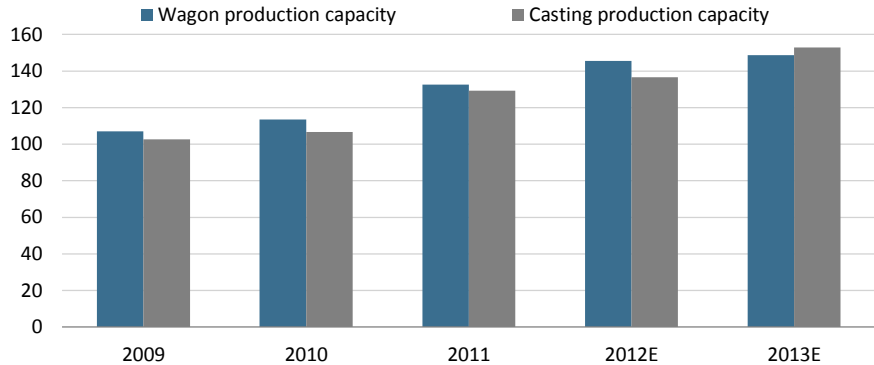
Source: PG-online, CIS statistic agencies, Concorde Capital

Spare parts – the key battlefield for 2012

Potential demand for railcars will be greater than actual supply in 2012

Historically, CIS railcar makers' production capacity has exceeded bogie casting supplies. The deficit of bogie casting will remain the key bottleneck for growth in the supply of railcars in 2012.

Casting and wagon production capacity in the CIS, ths wagons



Source: Company data, Concorde Capital

We estimate total bogie casting supply in the CIS at 130,000 railcar sets in 2012, of which 15,500 sets will be used on the aftermarket. Consequently, only 114,500 sets will be available for assembling new wagons in 2012. With potential railcar demand exceeding this number, competition for casting sets remains fierce this year.

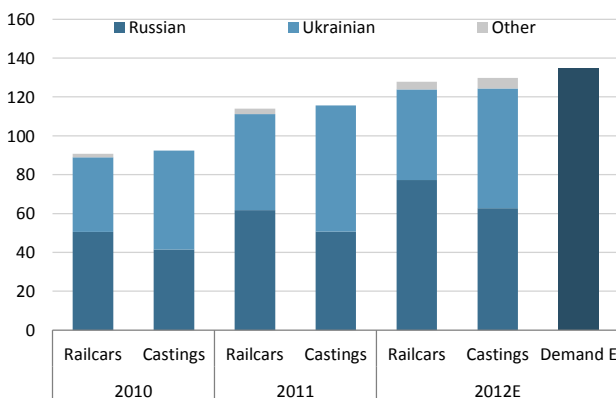
Stakhaniv Wagon can mitigate Ukrainian casting risks

Only one Ukrainian wagon maker, Stakhaniv Wagon has an alternate non-Ukrainian source of bogie castings supplies after its parent group acquired CKD Kutna Hora in February 2012. This makes it resilient to a casting deficit.

Casting deficit to be resolved in the mid-term

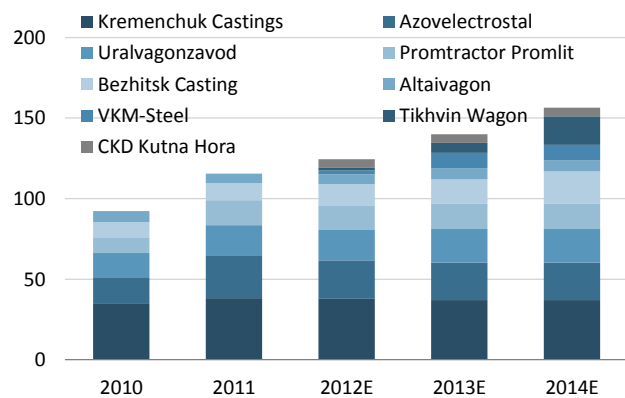
We expect Tikhvin Wagon and VKM-Steel will commission new casting production capacity to add 4,000 railcar sets to the market in 2012 and reach full capacity of 31,000 railcar sets p.a. in 2014.

CIS railcar output and casting* supplies, ths units



* Conventional set of bogie casting for assembling one freight railcar
Source: PG-online, Concorde Capital

Estimated CIS casting supply, ths railcar sets*



* Conventional set of bogie casting for assembling one freight railcar
Source: PG-online, Concorde Capital

Both Russian plants were to start casting production at the end of 2011, but as of today have only been operating trial runs. The commercial success of these projects will fully liquidate the wagon casting deficit in the CIS in the mid-term.

MID-TERM OUTLOOK: BUYERS TO BECOME MORE SELECTIVE

Summary: Diversification is key

The CIS railcar market outlook for the mid-term, unlike the short-term, is more favourable for Kryukiv Wagon, in our view.

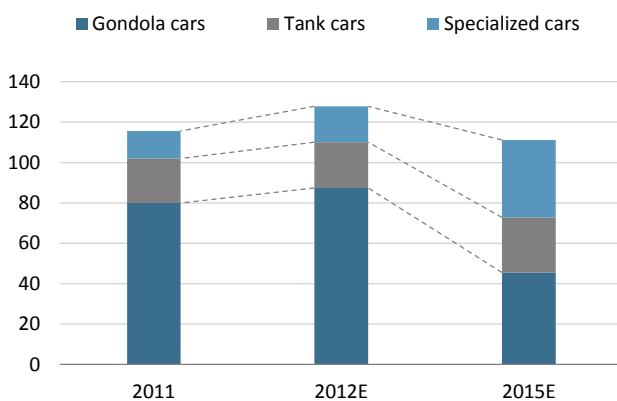
Diversification will be key for railcar producers in the mid to long-term. Having said this, we note that the only way in which this does not appear feasible is geographically: Russia will remain the key market.

The main trend that will determine the development of the railcar market in the future is an expected decline in demand in the CIS (read Russia), with a simultaneous increase in Russian production capacity. In turn, we expect Russia to increase protectionist measures. Two weak points of the Ukrainian railcar industry might be affected by Russian protectionism: the focus on standard gondola cars and reliance on domestic casting parts.

The following key features of Ukrainian wagon makers will define the sustainability of their fundamental value in the long-term:

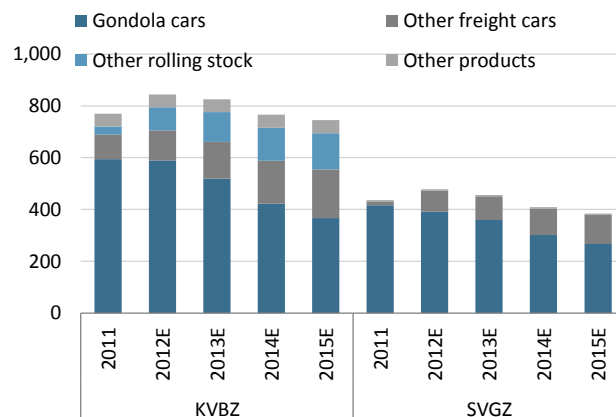
- **Diversification beyond freight railcars.** A wider product portfolio, aside from just freight railcars, will allow companies to maintain production levels when demand for their core product fades. Kryukiv Wagon, which also makes passenger and subway railcars, as well as other high value-added products, looks better prepared for that challenge.
- **Diversify your freight wagons or die.** The production of special purpose freight railcars that might fit the specific requirements of wagon buyers can become a significant competitive advantage in the mid-term. With its better R&D base, Kryukiv Wagon again looks preferable.
- **Geographical diversification of spare parts purchases.** One of the industry's main success drivers in the short-term, diverse casting supplies, will be critical in the long-term as well. With Russian wagon makers' dependence on Ukrainian casting on the decline, the risk of a protectionist-minded ban against Ukrainian casting parts will intensify. On this point, Stakhaniv Wagon, which has secured supplies from a related Czech enterprise, looks better protected.

CIS demand breakdown by freight railcar type, ths



Source: PG-online, Concorde Capital

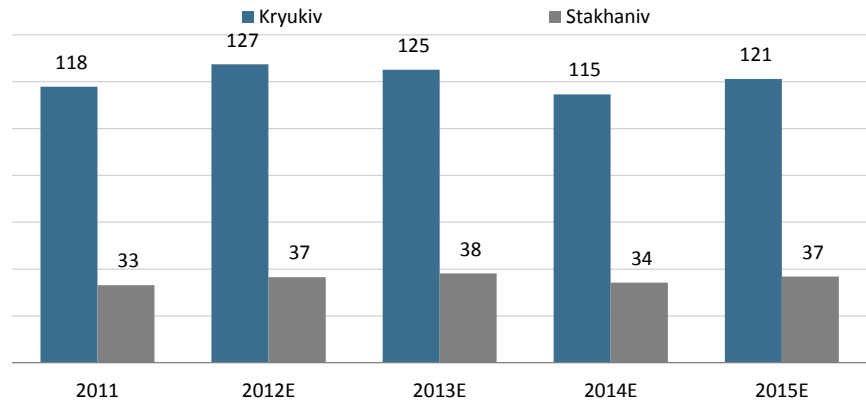
Sales breakdown, Stakhaniv vs. Kryukiv, USD mln



Source: Company data, Concorde Capital

We believe both covered wagon makers will decrease gondola car output by over 40% by 2015, while the decline will be compensated by an increase in other types of wagons and other railway machinery. This substitution, as well as eased prices for bogie casting (the key cost-inflation factor for 2011-2012) will allow the companies to raise their EBITDA in 2015 compared to 2012.

EBITDA evolution, USD mln



Source: Company data, Concorde Capital

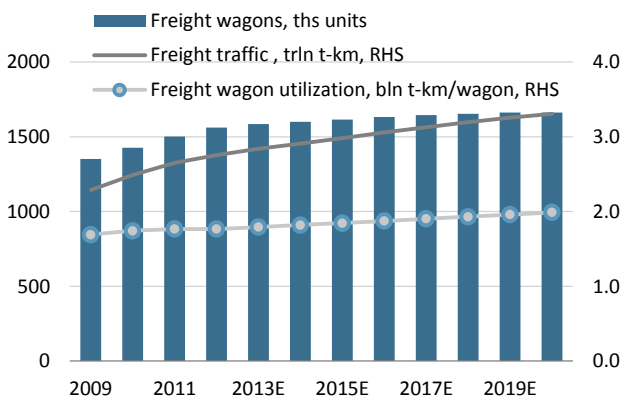
Wagon demand to start fading after 2013

We see the two main factors that will decrease CIS demand for new freight railcars in the mid-term:

- The exhaustion of pent up demand (a significant reduction in the historically low level of worn-out wagons needing replacement) will result in about a 40% decrease in new freight wagon purchases in 5-7 years
- An increase in railcar utilization that will lead to a decrease in the growth rate of the total number of railcars in the CIS, despite growing transportation needs

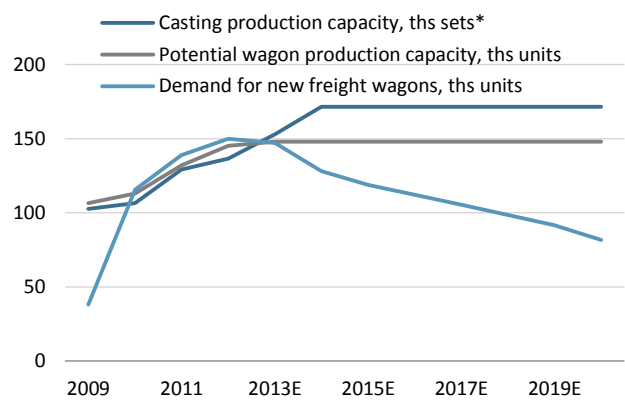
With both factors likely to kick in soon, we expect demand for new freight railcars to start fading already in 2013.

CIS railcar use stats, 2009-2020E



Source: CIS statistic agencies, Concorde Capital

Railcar demand and supply, 2009-2020E



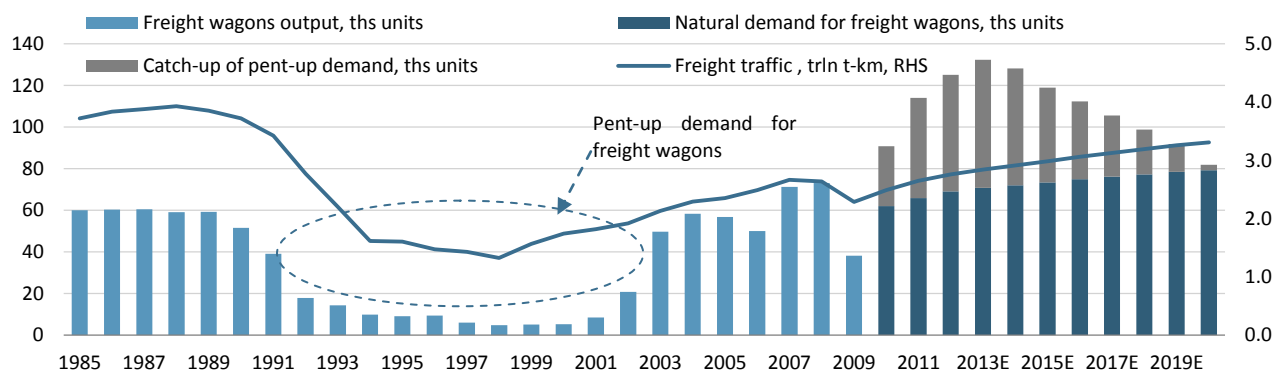
* Conventional set of bogie casting for assembling one freight railcar
Source: PG-online, Concorde Capital

Satisfying pent up demand: the key short-term sales driver

Something phenomenal is happening now on the CIS railcar market: despite 30% less freight railcar traffic compared to 1991, demand for new freight railcars is up almost twofold from the level in Soviet times.

Looking deeper into the numbers though, we conclude that only half of current demand is "natural," i.e. attributed to a reasonable level of replacement needs. Far more demand is pent up from the mid-1990s when no replacements occurred.

CIS freight railcars production, ths units



Source: USSR statistic yearbook, CIS statistic agencies, Concorde Capital

“Natural” demand for new freight railcars is a function of available wagons as each unit should be replaced after 21-23 years of use. We estimate natural CIS demand (excluding pent up demand) for new freight wagons at 60,000 units for 2011 and growing with the freight wagon fleet.

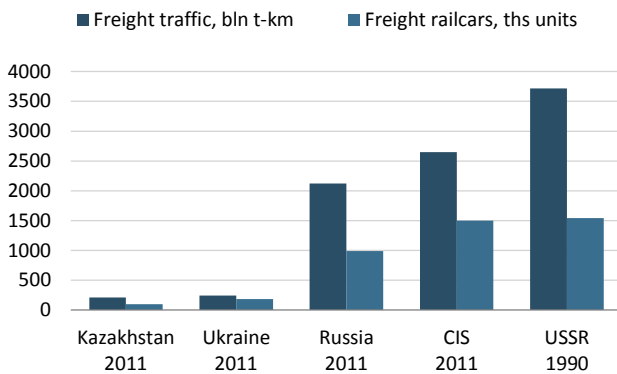
We estimate pent up demand at about 400,000 railcars now. We expect that the current production level of ~120,000 units p.a. will cover this demand in 6-7 years, allowing the market to stabilize at 80,000 units thereafter.

Efficiency improvement will inhibit CIS railcar fleet growth

We expect the total number of railcars in the CIS to grow only at 1% CAGR from 1,500 ths units currently to 1,660 in 2020, despite an increase in traffic at a 2.5% CAGR over the next decade on increased utilization of the average railcar.

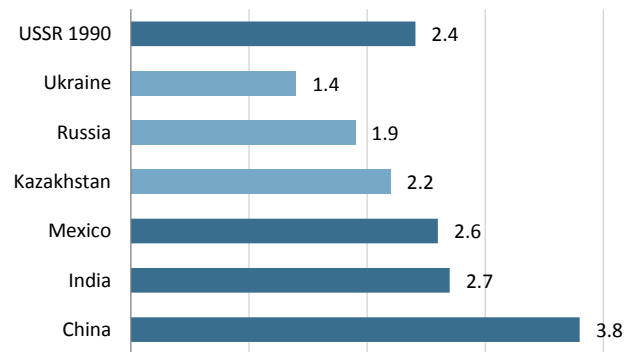
Over the last two decades though, there has been a sharp decline in railcar utilization. Though the actual number of freight railcars (1.5 million units), is roughly the same now as in Soviet times, freight turnover is down 40% from 3,717 bln t-km in 1990.

Freight railcar traffic vs. available railcars



Source: CIS statistic agencies, Concorde Capital

Freight railcar utilization by country, 2010



Source: China, India, Mexico statistic agencies, RZD, USSR statistic yearbook

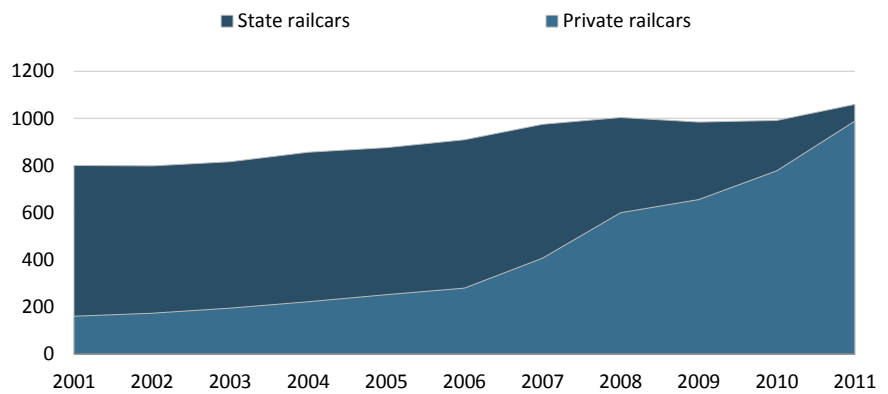
The key reasons for the decrease in railcar utilization are due to the market’s current transition period and will reverse, in our view:

- **Fracturing of the railcar market.** The liberalization of the Russian freight railcar market stimulated the emergence of private freight operators. Currently 72% (770,000 units) of total Russian freight railcars are operated by the 32 large companies (each owns over 5,000 units); the remaining is operated by 1.6 thousand small private operators. Smaller operators have a higher empty mileage ratio than monopolies, due to scale effect mainly.
- **Obsolete railcars dependent on repair.** There is a high share of railcars past their listed operational service lives in the CIS: 33% in Russia, 34% Kazakhstan and 45% in Ukraine. These obsolete freight railcars often require time-consuming repairs. For instance, Ukrzaliznytsya reports roughly 20% of its railcars are idle at any period of time due to repairs or maintenance. Russian Railways says that only 935,000 freight railcars in Russia (88% of total) were available for use as of end-2011, with the remaining were idle due to repairs or maintenance.

We expect railcar utilization in the CIS to increase in the mid-term for the following reasons:

- **Industry consolidation.** The Russian freight transportation industry is in the midst of a consolidation phase. As a result, we believe the priorities of largest players will soon shift from increasing market share via the acquisition of new wagons to improving efficiency via an increase in railcar utilization.

Russian freight railcars, ths units



Source: RZD, PG-online, Concorde Capital

- **Decreased maintenance-related idle time.** New railcars usually have higher utilization ratios as they require less maintenance time. Data from CIS operators suggest that by economizing on maintenance-related idle time, 100 obsolete railcars in the CIS can potentially be replaced by only 90 new units.
- **Increased unit capacity of new railcars.** At the same time, new railcars usually have 5-8% more cargo capacity (75 mt vs. 70 mt for older models), which allows for the substitution of 100 old wagons with only 95 new cars without a decrease in total transportation capacity. Moreover, the recent trend that is becoming visible and will drive the market in the future is a shift from universal multi-purpose wagons to specialized fitted for certain types of cargo. These railcars have faster loading/unloading times and thus enjoy better turnover.

Demand in Ukraine to double, adding little to aggregate CIS demand

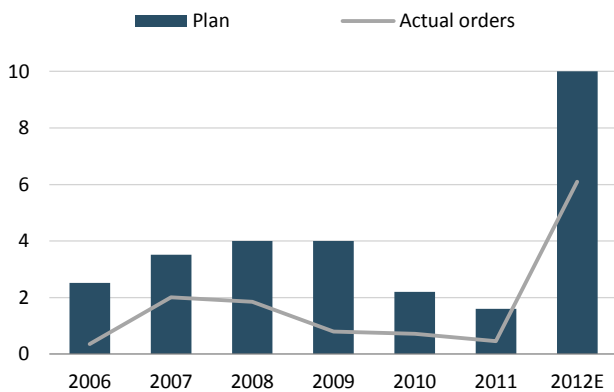
Reform of Ukrzaliznytsya to spur domestic railcar demand

The transformation of government entity Ukrzaliznytsya into a joint stock company and the transfer of its freight railcar fleet into a series of subordinated companies changed its railcars' status from "inventory" to "private" at the beginning of the year. The change means now they can be only used by permission from their owner. The reform will be a powerful driver of the recovery in Ukrainian demand for railcars for the following reasons:

- The new subordinated companies, with wagons on their balance sheet, will have better access to external financing to order more new cars.
- Tighter control over the railcars by owners will decrease railcar turnover in Ukraine and require railcar fleet expansion to secure current levels of freight traffic. "Inventory" railcars have 1.5x higher turnover than "private" units (6 days vs. 9 days for the latter), according to the current Ukrainian statistics.

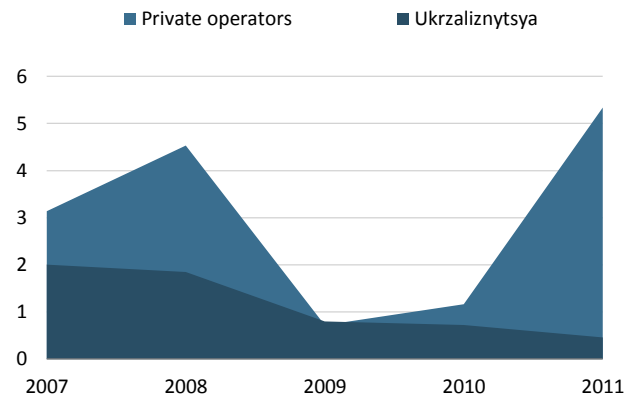
Ukrzaliznytsya has already announced plans to acquire 10,000 railcars for its subsidiaries in 2012, out of which 4,000 units would be ordered from independent railcar manufacturers. We, however, take a sceptical view of Ukrzaliznytsya's ability to execute its plan in full in 2012, given its history.

Ukrzaliznytsya's order plans vs. execution, ths units



Source: Ukrzaliznytsya, Concorde Capital

Breakdown of Ukrainian demand, ths units



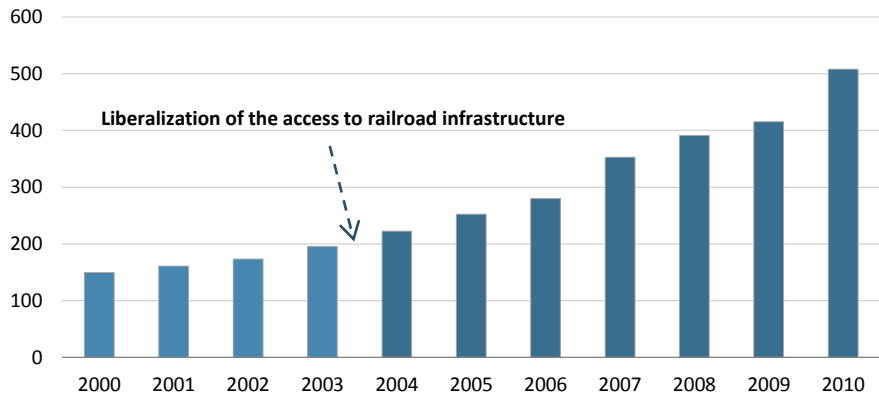
Source: Ukrzaliznytsya, Concorde Capital

Independent operators will boost their railcar fleets

The liberalization of access to the Ukrainian railroad infrastructure for all operators, which is to be adopted by parliament by December 2012, will allow private industrial and logistics companies to economize by using their own railcars. We believe the aggregate railcar fleet of Ukrainian independent operators will double within the next 5-7 years, which should result in annual orders of 10,000-15,000 freight railcars from 2013.

We believe Russia's experience is indicative: within the first five years it opened up access to its rail system, Russian private operators had acquired 168,100 freight railcars, almost doubling their total railcar fleet while Russian Railways had ordered only 59,500 units during the same period.

Evolution of Russian private operators' railcar fleets, ths units*



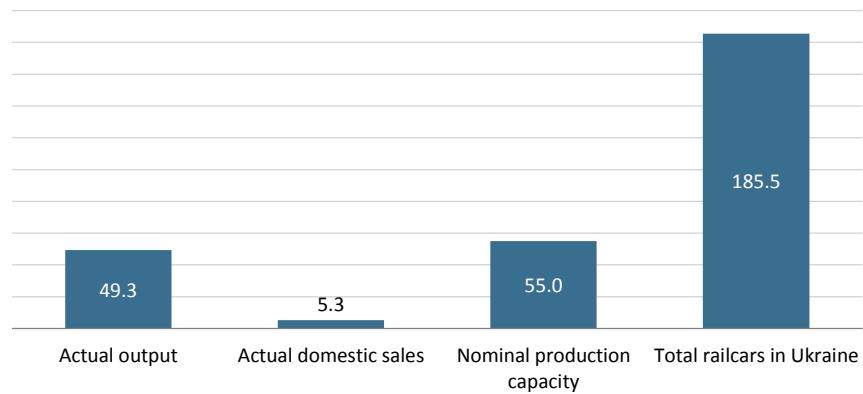
*Excluding railcars transferred by Russian Railways to its subsidiaries and private companies

Source: RZD, Concorde Capital

The Ukrainian market is too small for local producers

Growth in domestic demand will not however offset an anticipated decline in demand from Russia. Historically, Ukrainian railcar manufacturers have been export-oriented. Ukrainian demand consumes only 10% of domestic railcars made, which suggests that even a doubling or tripling in the domestic appetite will not change the situation much for local producers. Based on current production levels (49,000 units per year), Ukrainian railcar makers could replace every railcar in Ukraine in less than 3.5 years.

Selected Ukrainian freight railcar market data, ths units, 2011



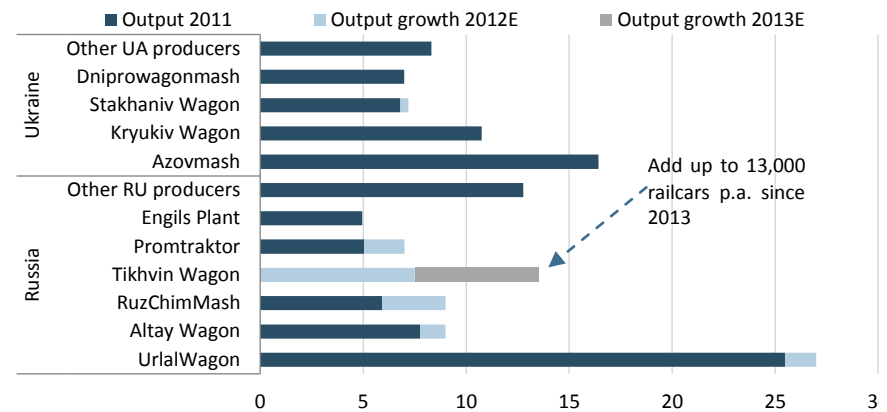
Source: PG-online, Concorde Capital

Russian supply, competition is growing

The announced plans of Russian railcar makers suggest supplies of both railcars and casting parts will exceed demand already in 2013. Moreover, we expect a gradual decline in CIS demand beginning next year, which suggests competition will only intensify.

The nominal production capacity of freight railcars in Russia is expected to increase ~30% (by 20,000 units p.a.) over the next two years. Existing players are adding up to 7,000 units p.a. and the new Tikhvin Wagon, commissioned in February 2012, will be capable of making up to 13,000 units p.a. in by the end of 2013.

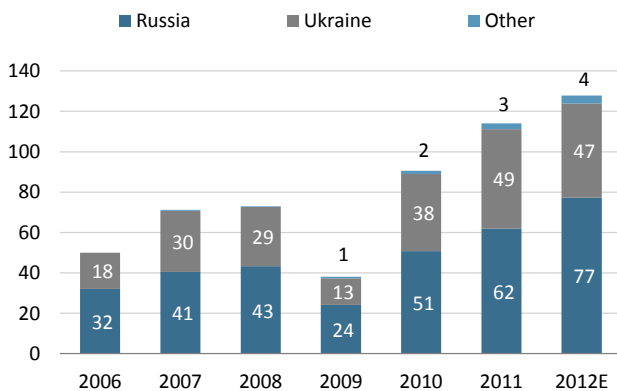
Top-10 CIS railcar makers' output, ths units



Source: PG-online, Concorde Capital

Though Russia represents about 90% of total CIS railcar demand, its aggregate share of total CIS output was only 54% in 2011. This gap is covered by producers from Ukraine, where production capacity exceeds potential internal demand. On the basis of high demand, Russian producers are continuing to expand their production capacity, which will likely lead to a decrease in Ukraine's share of the total CIS market from a record 43% in 2011 to 36% in 2012.

Breakdown of CIS freight railcar output, ths units



*Share of Russian producers for 2012 is based on their available production plans
Source: CIS statistic agencies, PG-online, Concorde Capital

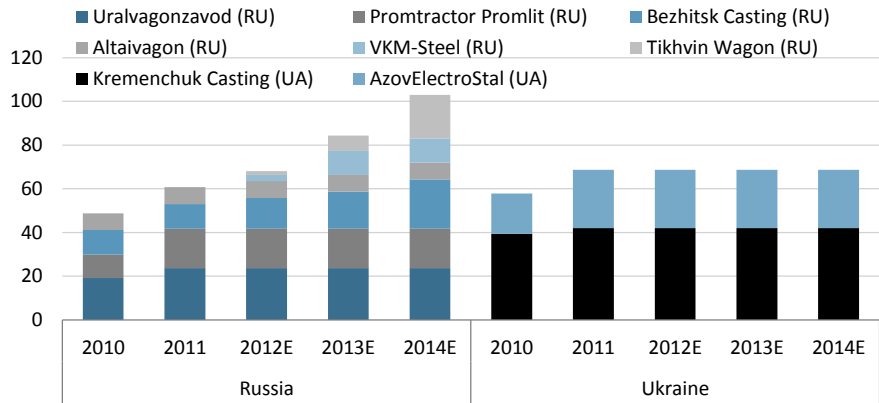
Ukrainian freight railcar destinations, ths units



Source: Ukrstat, Concorde Capital

The outlook for the railcar casting parts market is the same: based on the current plans of Russian wagon and steel producers, the aggregate supply of railcar casting parts, now in deficit in the CIS, will start exceeding railcar production needs in 2013.

Production capacity of CIS bogie casting makers, the railcar sets*

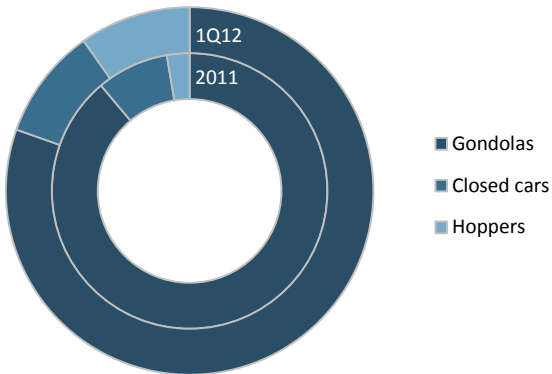


*Bases on the announced CIS casting producers' plans
Source: PG-online, Concorde Capital

Freight railcar specialization - key mid-term success factor

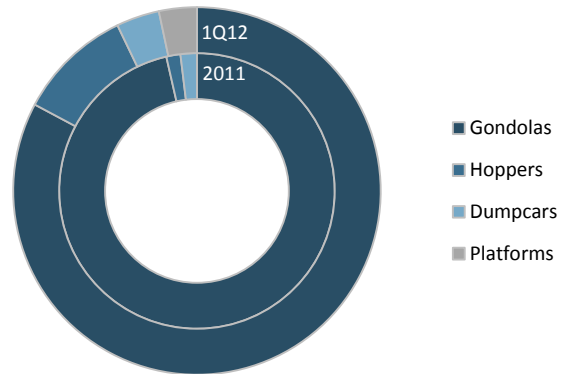
With the increase in production capacity in the CIS, freight railcars will become pure commodities on this market. The way to differentiate on this market and support sales is to increase focus on the niche of specialized wagons that fit the requirements of specific cargo types. Both Kryukiv and Stakhaniv Wagons seem to have picked up on this idea – their share of unified gondola cars in their overall production mix decreased significantly in favor of specialized wagons already in 1Q12.

Kryukiv Wagon freight car mix



Source: Company data

Stakhaniv Wagon freight car mix



Source: Company data

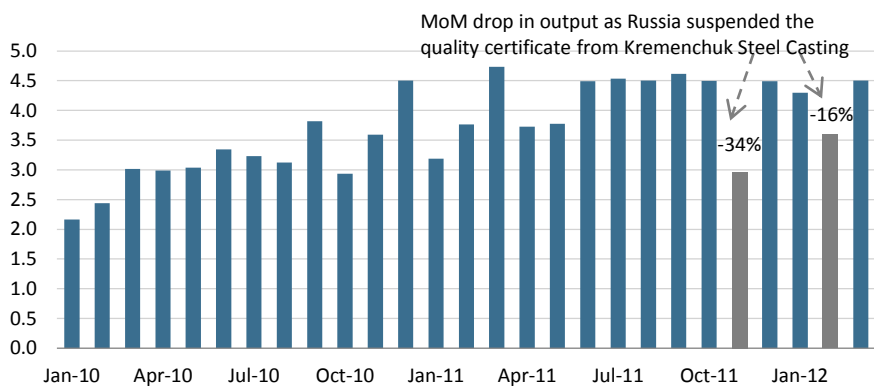
Russian protectionism – a key risk for Ukraine

Russia is clearly decreasing its dependence on Ukrainian freight wagons and railcar casting parts and rapid growth of wagon production in Russia will create an excess supply of railcars in the CIS. This means incentives to protect Russian producers are growing. So far unable to differentiate their products by quality and price, Russian producers have already proved efficient in using regulatory restrictions and black marketing to their advantage. In the mid-term, we expect this type of pressure on Ukrainian producers will only grow.

Ukrainian bogie casting certificate suspensions have become usual

Russia temporarily suspended the quality certificates of the two Ukrainian casting plants, Kremenchuk Steel Casting and Azovelektrostal (Azovmash group), which had a visible effect on Ukrainian railcar production in 2011 and 2012. Both Ukrainian plants account for 56% of total bogie casting production in the CIS and are nearly monopolistic suppliers of casting parts to all Ukrainian wagon producers.

Ukrainian railcar makers' monthly output, ths units



Source: Ukrstat, Concorde Capital

Most concerning to us is that if Russians dare to ban Ukrainian casting parts amid an overall casting deficit in the CIS, there is no telling what measures they will take when there is an excess of casting supplies.

Another way to minimize competition from Ukrainian wagon producers on the Russian market is illustrated below.

Case study: RZD does not recommend using railcars with Ukrainian casting

Russian Railways (RZD) issued a press release to warn rolling stock users of the risk of "poor quality" bogie casting from Kremenchuk Steel Casting Plant in early May 2012. The warning was based on the fact that 500 of more than 3,000 bogie frames found to have defects during an inspection were produced by Kremenchuk Casting. The plant is the CIS' largest casting producer: its share of casting parts used for the production of Russian-made railcars is about 35% (40% in the CIS), while the plant's share of defected parts revealed in survey was less than 17%.

Diversification of casting parts supply will be the key

Diversifying casting part supplies is the most straightforward way for domestic producers to cope with the risk of Russia initiating another quality certificate suspension for casting parts. Stakhaniv Wagon, which can supply up to 2/3 of its casting needs from Czech CKD Kutna Hora, seems the best protected listed local producer. Kryukiv Wagon, whose only casting supplier Kremenchuk Casting is physically located just over a fence, is more exposed to the risk of Russian re-suspending the latter's casting parts certification.

PROFITABILITY: COMMODITY-DRIVEN

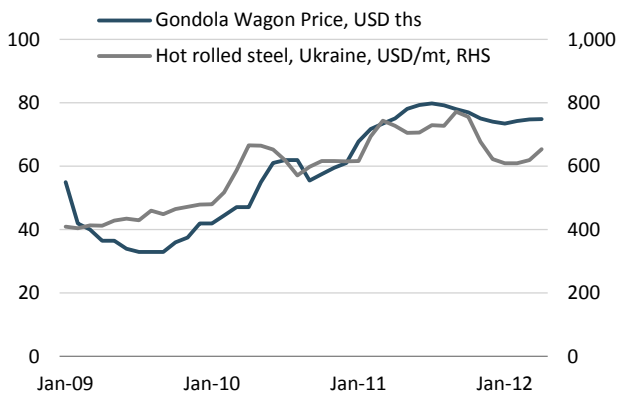
Steel & casting – key determinants of wagon costs

Materials account for more than 80% of railcar makers’ operating costs and are the equivalent of more than 60% of revenues. This is why railcar producers are quite sensitive to commodity prices on the cost side.

Monthly data shows that prices for freight railcars (universal gondolas) follow domestic steel with a time lag:

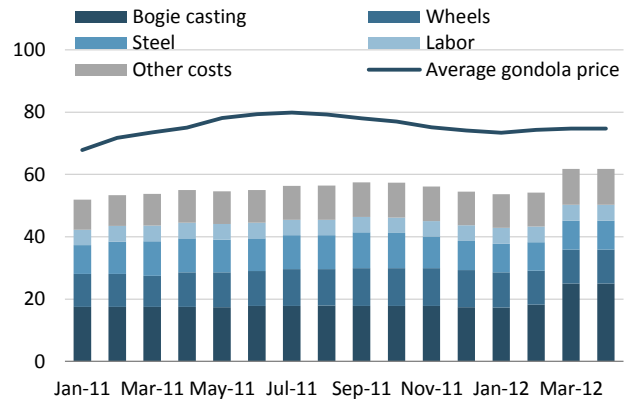
- Hot rolled steel plate accounts for ~20% of average freight railcar production costs and other steel products (e.g. bogie castings, wheels) account for another 54% of total COGS
- Metallurgical products and metallurgy-related commodities account for up to 45% of total rail traffic in the CIS. Growth in steel prices triggers an increase in its production and in turn stimulates demand for transportation, pushing wagon prices higher.

Gondola wagon price vs. domestic hot rolled steel



Source: Metal-courier, PG-online, Concorde Capital

Gondola wagon COGS breakdown, USD ths



Source: Metal-courier, PG-online, Concorde Capital

Despite an observed correlation between railcars and steel commodities, railcar prices are much less volatile currently for the following structural reasons:

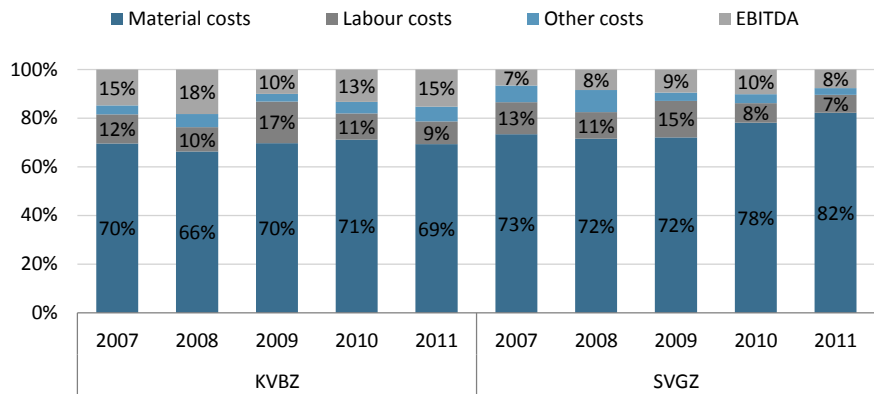
- There is still existing pent up demand for freight railcars in the CIS, which is a function of the units’ age rather than of freight transportation needs. Railcar producers are price setters on the market
- Bogie casting parts, one of the key components for freight railcars, is one of the scarcest to come by. Its price has remained high over the last two years, keeping wagon producers’ costs (and prices) at relatively high levels.

Higher value added products determine higher EBITDA margins

Both covered Ukrainian railcar producers have a low degree of operating leverage: their EBITDA margins appeared to be determined by raw material prices (which was higher in 2011) more than volumes of output. The only factor that seemed to be too sticky to determine the companies' operating leverage was workforce expenses: the drops in sales observed at Kryukiv Wagon in 2010 and at Stakhaniv Wagon in 2009 decreased the companies' margins solely due to an increased share of workforce-related costs.

What is also important for the two wagon makers is that Kryukiv has had a sustainably higher historical EBITDA margin due to a higher share of value-added products. Freight wagons account for about 90% of its sales (vs. almost 100% for Stakhaniv), with the remaining contributed by passenger wagons and other railway machinery.

Common size financials



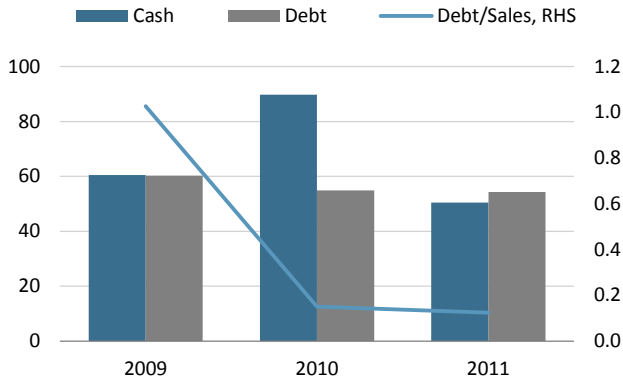
Source: Company data, Concorde Capital

Company-specific income determinants

Stakhaniv's bottom line suffers from an unnecessary debt burden

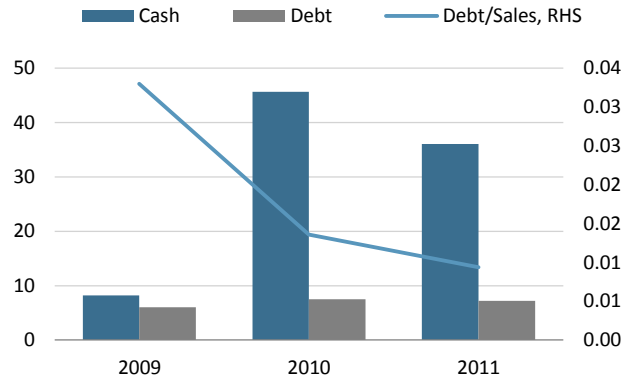
Compared to Kryukiv Wagon, Stakhaniv has a large amount of outstanding debt, which to the best of our knowledge has little to do with the company's operations – the debt is fully offset by the company's cash balance.

Stakhaniv cash and debt position, EOP, USD mln



Source: Company data

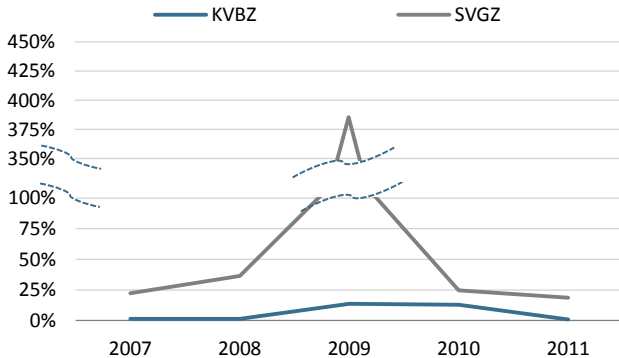
Kryukiv cash and debt position, EOP, UAH mln



Source: Company data

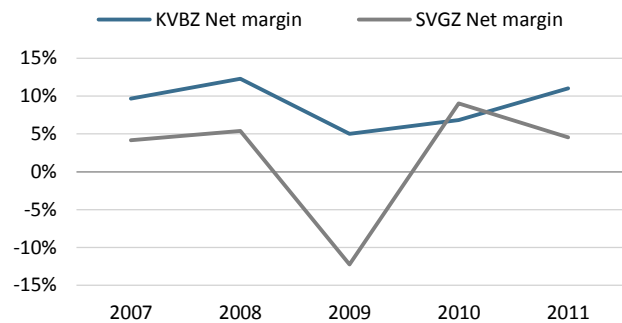
Stakhaniv's debt ate away 2.3 pp of its net margin in 2010 and 1.3 pp in 2011, compared to Kryukiv's 1.5 pp in 2010 and 0.1 pp in 2011.

Financial expenses as % of EBIT



Source: Company data, Concorde Capital

Net margin evolution

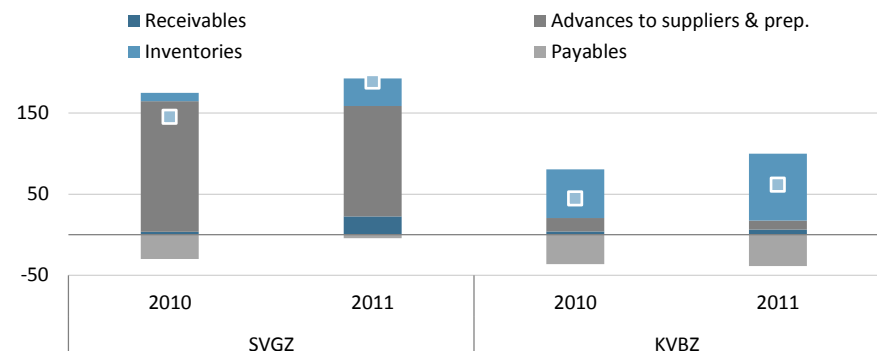


Source: Company data, Concorde Capital

Stakhaniv's cash frozen in advances – the victim of spare part imports

Stakhaniv Wagon has an almost 10x longer period to recover advances to suppliers and therefore 3x longer cash operating cycle than Kryukiv Wagon (as of end-2011). We attribute this to Stakhaniv's importing a significant share of casting parts from the Czech Republic since late 2010.

Cash conversion cycle, days



Source: Company data, Concorde Capital

COMPANY PROFILES

KRYUKIV WAGON

Strength through diversity

A bright spot in Ukraine's investable universe

Kryukiv represents a small group of profitable companies in the most liquid pool of local Ukrainian stocks. It is the second largest Ukrainian railway engineer with the most diversified product portfolio, which makes its long-term profit less vulnerable to a decrease in freight railcar demand.

Lives on orders from abroad, counts on a recovery in domestic demand

Kryukiv Wagon is the second-largest actively-traded Ukrainian machinery exporter after Motor Sich as of 2011. Unable to supply passenger cars to Russia, the company has benefited from Belarusian demand in the past and from Kazakh orders currently. In the freight segment, it has already seen the first large (1,000-units) order from Ukrzaliznytsya in February. Sales of a new high-speed passenger train and the modernization of Kyiv subway wagons are among the most promising projects. More local orders in the passenger and freight segments will follow in the mid-term.

Financially healthy, one of few local dividend payers

Kryukiv has low leverage and a strong cash position. Its profitability is one of the highest in the local railcar sector. The company is also one of the few dividend-paying stocks in the Ukrainian universe.

Key weakness: reliance on a single casting supplier

The expected decrease in freight railcar demand from Russia in the mid-term puts the stability of Kryukiv's wagons supplies to Russia at risk. The company is vulnerable to a Russian quality-related ban on the use of casting parts from its only supplier.

Company description

Kryukiv Wagon is Ukraine's largest standalone railway equipment manufacturer. It produces freight and passenger railcars, subway wagons and escalators, provides railcar maintenance, repairs and modernization services. The company designs and builds bulk commodity cars, intermodal cars, tank cars and high-speed passenger wagons.

Selected financials and ratios

| | 2010 | 2011 | Chg,yoy | 2012E | Chg, yoy |
|----------------------------|-------|-------|---------|-------|----------|
| Net revenue | 551 | 770 | 39.9% | 844 | 9.6% |
| Gross margin, % | 18.0% | 21.3% | 3.3pp | 19.3% | -2.0pp |
| EBITDA | 73 | 118 | 61.0% | 127 | 8.1% |
| EBITDA margin, % | 13.3% | 15.3% | 2.0pp | 15.1% | -0.2pp |
| Net income | 38 | 85 | 125.6% | 94 | 10.8% |
| Net margin, % | 6.8% | 11.0% | 4.2pp | 11.1% | 0.1pp |
| PP&E, net | 41 | 57 | 38.6% | 73 | 29.9% |
| Shareholder equity | 189 | 258 | 36.8% | 296 | 14.6% |
| LT debt | 0 | 0 | 0.0% | 0 | 0.0% |
| ST debt | 7 | 7 | -3.3% | 7 | 0.0% |
| Total liabilities & equity | 71 | 104 | 47.4% | 93 | -10.4% |
| CapEx | 7 | 23 | 227.1% | 24 | 4.0% |
| Current ratio | 2.7 | 2.7 | -0.3% | 3.1 | 15.3% |
| Net debt/Equity | -0.2 | -0.1 | -44.9% | -0.2 | 38.3% |
| ROA | 14.5% | 23.4% | 8.9pp | 24.2% | 0.7pp |
| ROE | 20.0% | 32.9% | 12.9pp | 31.8% | -1.1pp |
| ROIC | 32.0% | 37.0% | 5.0pp | 38.2% | 1.1pp |

Source: Company Data, Concorde Capital estimates

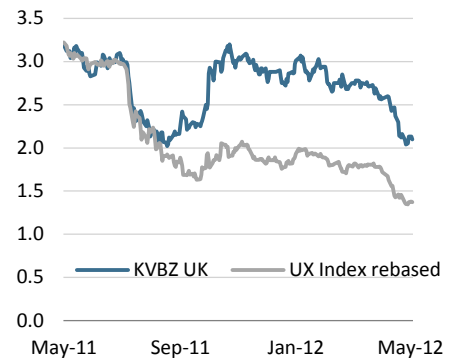
Operations

| | 2010 | 2011 | Chg, yoy | 2012E | Chg, yoy |
|-----------------------------|-------|--------|----------|--------|----------|
| Freight wagons production | 8,836 | 10,750 | 21.7% | 10,200 | -5.1% |
| Passenger wagons production | 38 | 28 | -26.3% | 49 | 75.0% |
| Subway wagons production | 20 | 0 | n.a. | 0 | n.a. |

Source: Company data, Concorde Capital

KVBZ UK Current: USD 2.1 [BUY]
Target: USD 5.0

Share price performance *



* Hereafter, share prices as of May 31, 2012

Source: Bloomberg

Market data

| Bloomberg | KVBZ UK |
|--------------------------------|---------|
| Current price, USD | 2.1 |
| MCap, USD mln | 241.3 |
| Net Debt, USD mln | -28.8 |
| EV, USD mln | 212.5 |
| Free float, % | 4.7% |
| Free float, USD mln | 11.3 |
| Common shares outstanding, mln | 114.7 |
| Change from 52W low, % | 3.9% |
| Change from 52W high, % | -34.1% |
| 1M change, % | -18.2% |
| 3M change, % | -23.9% |
| 12M change, % | -34.1% |

Source: Bloomberg

Ownership structure

| | |
|--------------------------------|-------|
| AS Skinest Finants | 25.2% |
| Transbuilding Service Limited, | 24.9% |
| Teko-Dneprometiz | 23.3% |
| Osauhing Divinta | 14.5% |
| Other | 7.4% |
| Free-float | 4.7% |

Source: Company data, Concorde Capital

Multiples and per-share data

| | 2010 | 2011 | 2012E |
|--------------------|-------|-------|-------|
| EV/Output, USD ths | 23.89 | 21.20 | 20.68 |
| EV/Sales | 0.39 | 0.28 | 0.25 |
| EV/EBITDA | 2.90 | 1.80 | 1.67 |
| P/E | 6.40 | 2.84 | 2.56 |
| P/B | 0.93 | 0.66 | 0.62 |
| BPS, USD | 1.64 | 2.25 | 2.58 |
| EPS, USD | 0.33 | 0.74 | 0.82 |
| DPS, USD | 0.07 | 0.15 | 0.49 |

Source: Bloomberg, Company data, Concorde Capital

Company overview

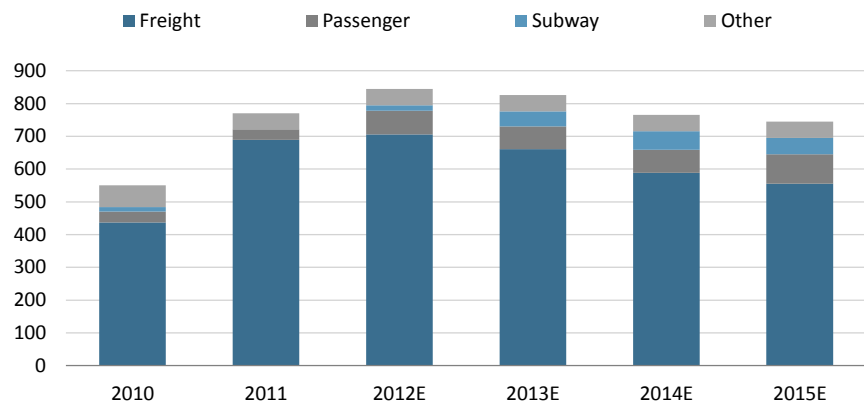
Ukraine's only diversified railcar producer

Kryukiv Wagon is Ukraine's second largest freight railcar builder and only producer of passenger and subway wagons. The company's business consists of three core divisions: freight, passenger and subway, as well as two complementary segments: custom metal steelworks and motor graders.

Key strength: Long-term play, insured from a decline in the freight segment

We believe Kryukiv's diversified product portfolio will allow the company to avoid the negative effect of fading demand for one of its core products - gondola railcars. Considering Ukraine's steps toward the modernization of its passenger rail transport fleet in 2011, we believe the company's passenger segment will become a powerful value driver in the long-term.

Breakdown of Kryukiv Wagon's sales, USD mln



Source: Company data, Concorde Capital

Key weakness: Sensitivity to bogie casting supply disruptions in 2012

Lacking its own bogie casting production capacity, the company is totally dependent on external sources - mainly the CIS' biggest supplier, Kremenchuk Steel Casting, which is located just over the fence from Kryukiv Wagon. The company's output is vulnerable to any new suspensions in the quality certificate of the Kremenchuk plant.

SWOT

Strengths

Vast portfolio of freight railcars
Flexibility to produce custom freight railcars
Only producer of passenger and subway wagons in Ukraine

Opportunities

Increase of in order flow after the reform of Ukrzaliznytsya
Expansion of Kyiv subway
Commercialization of new high-speed locomotive-hauled passenger wagons

Weaknesses/Limitations

Lack of own bogie casting production
Dependence on a single supplier for bogie casting
Dependence on Russian freight railcar market

Threats

New players entering the market
Expansion of production capacity by existing competitors
Suspension of a quality certificate from the company or its suppliers
Saturation of freight railcar market in Russia in 2013/2014

Source: Concorde Capital

Outlook for growth

Freight railcars: Start benefiting from the reform of Ukrzaliznytsya

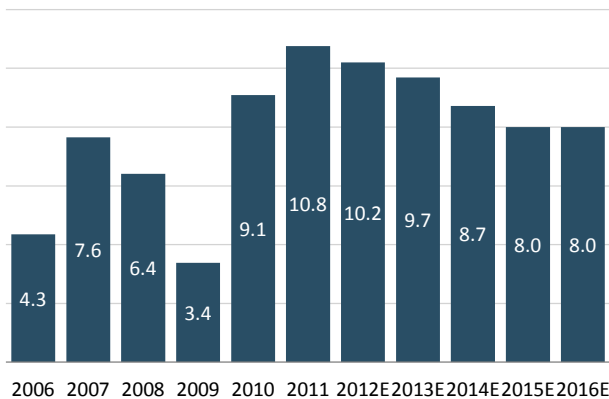
Kryukiv Wagon has already enjoyed the first fruits of Ukrainian rail transport reform. In the end of February, Ukrzaliznytsya announced that it will order the first 1,000 new railcars from Kryukiv Wagon (10% of its 2012E output), using USD 62.5 mln of an EBRD loan. We expect the reform will intensify the orders flow from Ukrainian state-owned and private railcar operators, which eases the threat of possible freight railcar import limitations to Russia.

Even though high demand is here to stay this year, we expect Kryukiv Wagon to cut its annual production by 5% yoy in 2012 as possible new disruptions in spare parts from Kremenchuk Steel Casting will not allow the company to fully transform its order book for the year into real sales. Moreover, we believe that the CIS freight railcar market will reach saturation already in 2013-2014 as major operators fulfill their modernization plans. This will force Kryukiv Wagon to cut its freight wagon output to 8,000 units p.a. by 2015, or by 26% compared to the 2011 level.

Passenger railcars: a key growth potential

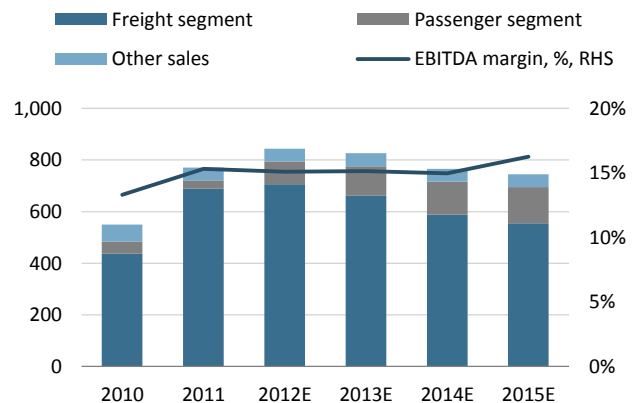
The company currently enjoys an average gross margin of 30% in its passenger car segment vs. 20% in its freight segment. Despite a small share of passenger railcars sales in revenues (4.3% in 2011), this segment has the highest growth potential. Ukraine has a passenger railcar fleet of 7,000 units today, 60% of which is out of date and requires modernization or replacement. This is beneficial for the company as Kryukiv Wagon is the only Ukrainian producer capable of manufacturing passenger railcars.

Kryukiv freight railcars annual production, ths units



Source: Company data, Concorde Capital

Kryukiv revenues breakdown, USD mln



Source: Company data, Concorde Capital

CIS ex-Russia – the major passenger cars consumers

Unlike freight cars, Kryukiv Wagon has never exported its passenger wagons to Russia mainly due to high competition between local producers and the unwillingness of Russian Railways to import railcars. Ukraine, Belarus and Kazakhstan have been and will remain the major markets for Kryukiv Wagon in terms of passenger wagon sales:

- After purchasing its first 12 passenger wagons from Kryukiv in 2011, Kazakhstan has placed another order for 49 new wagons in 2012. We expect Kazakhstan will continue ordering about 40 passenger wagons p.a. over the next couple of years, which would generate annual revenue of USD 50 mln for the company in 2012-2014.

- Kryukiv Wagon was certified to produce 90 high-speed wagons (for 10 locomotive-hauled trains); the first nine were sold to Ukrzaliznytsya for USD 18.75 mln in the 2012 financial year. As the trains are typically used in pairs, we expect 9 more high speed wagons to be purchased by 2013, adding up to USD 20 mln to the company's revenues.
- In the mid-term, we expect Kryukiv will produce 45 passenger wagons p.a. for the domestic and other CIS markets.

Expansion of the Kyiv subway system – a long-term growth opportunity

Plans to expand the Kyiv city subway system envision the construction six stations on a brand new Podilsko-Vygurivska line by the end of 2015 and another six by 2025. We estimate that each new station will require adding at least two trains (12 wagons) to the total subway railcar fleet and four escalators. As the only Ukrainian company capable of producing subway wagons, Kryukiv Wagon has a high chance of being awarded the contract for an estimated 72 subway wagons in 2013-2015, generating in total USD 80 mln from the deal.

Another revenue driver in the subway segment is the overhaul of 185 outdated Kyiv subway wagons in 2012-2014, which will bring in another USD 120 mln to the company.

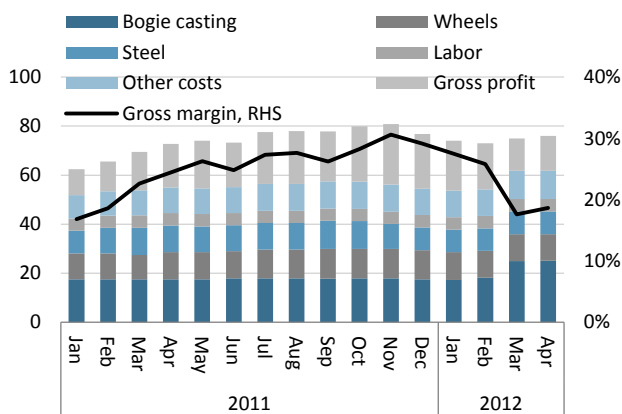
Financial performance

Cost inflation will send Kryukiv's gross margin down 2 pp in 2012

Backed by an increase in its average sale price in the core freight segment, Kryukiv Wagon's gross profit grew 66% yoy to USD 164 mln in 2011.

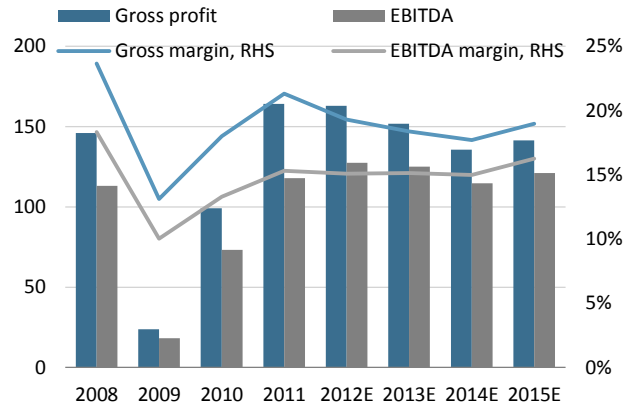
We expect average 2012 prices for freight railcars will remain at the level seen at the end of 2011 (USD 75 ths), which in fact will be 18% yoy more than average 2011 prices. We also anticipate annual average bogie casting prices will grow 10% yoy, while steel plate will fall 3% yoy in 2012. Raw materials cost inflation will eat away 2 pp from Kryukiv's gross margin in 2012, which we expect will cut the company's total gross profit by 0.8% yoy to USD 163 mln.

Kryukiv average freight railcar costs breakdown, USD ths



Source: Company data, Concorde Capital

Profitability, USD mln

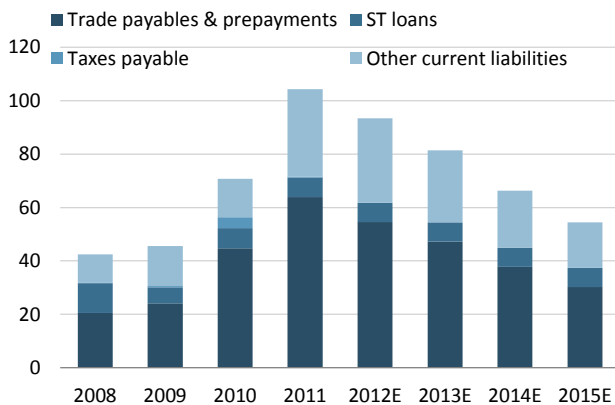


Source: Company data, Concorde Capital

A cash-rich company

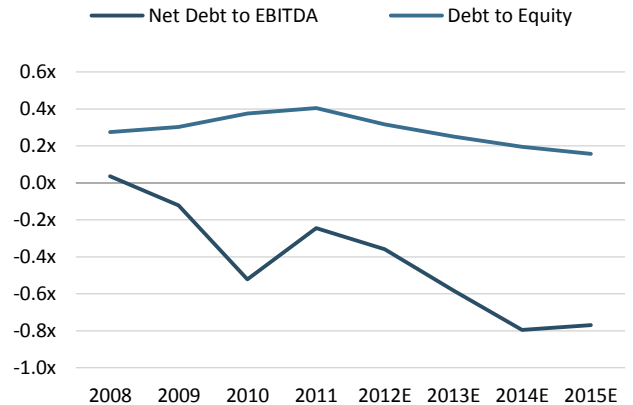
The large amount of prepayments is an indicator of high demand for the company's products - a phenomenon that may persist in the short to mid-term.

Liabilities breakdown, USD mln



Source: Company data, Concorde Capital

Kryukiv debt evolution



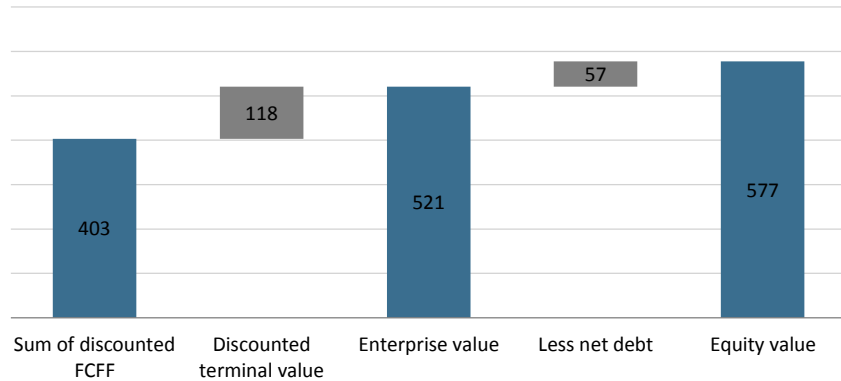
Source: Company data, Concorde Capital

The company's ability to finance its working capital and CapEx using its own resources has translated into overall low leverage: total debt amounted to just USD 7.2 mln, while net debt was negative USD 28.8 mln as of end-2011. The accumulated cash balance and hefty prepayments received allow the company to fully finance its operations and capital expenditures without seeking new debt.

Valuation

We assign a 12M target price of USD 5.03/share for Kryukiv Wagon shares based on DCF valuation. This implies 139% upside. We initiate coverage with a BUY recommendation.

Kryukiv Wagon DCF valuation summary, USD mln



Source: Concorde Capital

Operating model assumptions for Kryukiv Wagon

Wagons output, units

| | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|-----------------------------|---------------|---------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Hoppers | 285 | 500 | 800 | 1,000 | 1,100 | 1,100 | 1,100 | 1,100 | 1,100 | 1,100 |
| Gondolas | 8,802 | 8,730 | 7,840 | 6,521 | 5,550 | 5,550 | 5,550 | 5,550 | 5,550 | 5,550 |
| Closed cars | 907 | 950 | 1,000 | 1,100 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 |
| Platforms | 0 | 20 | 50 | 100 | 150 | 150 | 150 | 150 | 150 | 150 |
| Total freight cars | 10,750 | 10,200 | 9,690 | 8,721 | 8,000 | 8,000 | 8,000 | 8,000 | 8,000 | 8,000 |
| <i>yoy change</i> | n/a | -5% | -5% | -10% | -8% | 0% | 0% | 0% | 0% | 0% |
| High-speed passenger cars | 0 | 9 | 9 | 9 | 9 | 9 | 9 | 9 | 9 | 9 |
| Common passenger | 28 | 49 | 45 | 45 | 60 | 60 | 60 | 60 | 60 | 60 |
| Subway cars | 0 | 25 | 68 | 65 | 35 | 10 | 10 | 10 | 10 | 10 |
| Subway cars (Modernization) | 0 | 0 | 0 | 12 | 24 | 24 | 24 | 24 | 24 | 24 |

Source: Company data, Concorde Capital

Price, USD ths/wagon

| | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|-----------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Hoppers | 76 | 76 | 74 | 73 | 74 | 76 | 77 | 79 | 81 | 82 |
| Gondolas | 68 | 68 | 66 | 65 | 66 | 67 | 69 | 70 | 72 | 73 |
| Closed cars | 81 | 81 | 79 | 78 | 79 | 81 | 83 | 84 | 86 | 88 |
| Platforms | 76 | 76 | 74 | 73 | 74 | 75 | 77 | 78 | 80 | 82 |
| High-speed passenger cars | 1,850 | 1,850 | 1,887 | 1,925 | 1,963 | 2,002 | 2,043 | 2,083 | 2,125 | 2,168 |
| Common passenger | 1,135 | 1,135 | 1,158 | 1,181 | 1,204 | 1,229 | 1,253 | 1,278 | 1,304 | 1,330 |
| Subway cars | 1,000 | 1,020 | 1,040 | 1,061 | 1,082 | 1,104 | 1,126 | 1,149 | 1,172 | 1,195 |
| Subway cars (Modernization) | 675 | 675 | 675 | 675 | 675 | 675 | 675 | 675 | 675 | 675 |

Source: Company data, Concorde Capital

Key cost components, USD ths/wagon

| | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|-------------------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Steel casting | 17.7 | 19.4 | 18.5 | 17.9 | 18.3 | 18.6 | 19.0 | 19.4 | 19.8 | 20.2 |
| <i>yoy change</i> | n/a | 10% | -5% | -3% | 2% | 2% | 2% | 2% | 2% | 2% |
| Wheels | 11.3 | 11.6 | 11.8 | 12.0 | 12.3 | 12.5 | 12.8 | 13.0 | 13.3 | 13.6 |
| <i>yoy change</i> | n/a | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% |
| Steel | 10.5 | 10.1 | 10.3 | 10.6 | 10.8 | 11.0 | 11.2 | 11.4 | 11.7 | 11.9 |
| <i>yoy change</i> | n/a | -3% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 3% |
| Salaries, wages and related charges | 5.0 | 5.1 | 5.2 | 5.3 | 5.4 | 5.5 | 5.6 | 5.7 | 5.8 | 6.0 |
| <i>yoy change</i> | n/a | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% |

Source: Company data, Concorde Capital

Discount rate and perpetuity assumptions

We apply a 19.5% cost of equity for valuation purposes, which encompasses a 4% company-specific premium, which we apply to account for business risks (raw materials supply) and stock liquidity. We apply a 1% perpetuity growth rate assumption and WACC in perpetuity at 19%.

WACC decomposition

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---------------------------|--------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Gov't eurobond yield | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% |
| Equity premium | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Company-specific premium | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% |
| Cost of equity | 19.5% | 19.5% | 19.5% | 19.5% | 19.5% | 19.5% | 19.5% | 19.5% | 19.5% | 19.5% |
| Cost of debt (after tax) | 11.4% | 14.2% | 14.6% | 14.7% | 14.3% | 13.4% | 13.4% | 13.4% | 13.4% | 13.4% |
| D/E | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Share of equity | 0.97 | 0.98 | 0.98 | 0.98 | 0.98 | 0.98 | 0.98 | 0.98 | 0.98 | 0.98 |
| WACC | 19.3% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% |
| WACC To Perpetuity | 19.0% | | | | | | | | | |

Source: Company data, Concorde Capital

Discounted cash flow model

USD mln, unless other specified

| | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------------------------|-------|
| EBIT | 120.4 | 116.8 | 105.0 | 110.2 | 110.0 | 111.2 | 112.7 | 114.3 | 115.5 | 117.3 |
| - Tax expense | -25.0 | -21.9 | -16.6 | -17.4 | -17.4 | -17.6 | -17.8 | -18.1 | -18.3 | -18.6 |
| Effective tax rate, % | 24% | 21% | 19% | 16% | 16% | 16% | 16% | 16% | 16% | 16% |
| - Tax shield on interests | -0.3 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |
| + D&A | 7.1 | 8.3 | 9.7 | 11.0 | 12.1 | 13.1 | 14.0 | 14.7 | 15.3 | 15.5 |
| - CapEx | -24.2 | -25.0 | -25.0 | -22.0 | -20.0 | -18.0 | -16.0 | -15.0 | -15.4 | -15.5 |
| - Increase in working capital | -3.4 | 16.4 | 16.2 | 9.2 | 3.7 | -2.1 | -2.2 | -2.2 | -2.4 | -2.4 |
| FCFF | 74.5 | 94.3 | 89.0 | 90.7 | 88.3 | 86.4 | 90.4 | 93.5 | 94.6 | 96.1 |
| WACC | | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% | 19.4% |
| Discount factor | | 0.90 | 0.75 | 0.63 | 0.53 | 0.44 | 0.37 | 0.31 | 0.26 | 0.22 |
| Discounted FCFF @ May-31-2013 | | 85.0 | 67.2 | 57.3 | 46.7 | 38.3 | 33.6 | 29.1 | 24.7 | 21.0 |
| Terminal value (TV) | | | | | | | | | | 539.1 |
| | | | | | | | | | Implied EBITDA multiple | 4.1 x |
| | | | | | | | | | TV as % of EV | 23% |
| Sum of discounted FCFFs | | | 402.8 | | | | | | | |
| TV @ 31-May-2013 | | | 117.7 | | | | | | | |
| Enterprise value | | | 520.5 | | | | | | | |
| Less net debt | | | 56.8 | | | | | | | |
| Equity value | | | 577.4 | | | | | | | |
| Value per share, USD | | | 5.0 | | | | | | | |
| Terminal value assumptions: | | | | | | | | | | |
| Perpetuity growth rate | | | 1.0% | | | | | | | |
| WACC in perpetuity | | | 19.0% | | | | | | | |

Source: Company data, Concorde Capital

Sensitivity tables, USD per share

| WACC | Perpetuity Growth Rate | | | | | WACC | Exit Multiple (EBITDA) | | | | |
|-------|------------------------|------|------|------|------|------|------------------------|-------|-------|-------|-------|
| | 0.0% | 0.5% | 1.0% | 1.5% | 2.0% | | 3.1 x | 3.6 x | 4.1 x | 4.6 x | 5.1 x |
| 17.0% | 5.08 | 5.12 | 5.16 | 5.21 | 5.25 | 2.0% | 5.12 | 5.26 | 5.41 | 5.56 | 5.70 |
| 18.0% | 5.02 | 5.06 | 5.09 | 5.13 | 5.17 | 1.0% | 4.94 | 5.08 | 5.22 | 5.35 | 5.49 |
| 19.0% | 4.97 | 5.00 | 5.03 | 5.07 | 5.11 | 0.0% | 4.78 | 4.91 | 5.03 | 5.16 | 5.29 |
| 20.0% | 4.92 | 4.95 | 4.98 | 5.01 | 5.04 | 1.0% | 4.63 | 4.75 | 4.86 | 4.98 | 5.10 |
| 21.0% | 4.88 | 4.90 | 4.93 | 4.96 | 4.99 | 2.0% | 4.49 | 4.59 | 4.70 | 4.81 | 4.92 |

Source: Concorde Capital

Financials

Income statement, USD mln

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E |
|----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Net revenue | 617.3 | 182.2 | 550.6 | 770.3 | 844.4 | 826.0 | 765.6 | 745.0 |
| Gross profit | 146.1 | 23.9 | 99.1 | 164.2 | 163.0 | 151.7 | 135.6 | 141.4 |
| Gross margin | 23.7% | 13.1% | 18.0% | 21.3% | 19.3% | 18.4% | 17.7% | 19.0% |
| EBITDA | 113.1 | 18.3 | 73.2 | 117.9 | 127.4 | 125.1 | 114.7 | 121.2 |
| EBITDA margin | 18.3% | 10.0% | 13.3% | 15.3% | 15.1% | 15.1% | 15.0% | 16.3% |
| D&A | -5.7 | -4.3 | -5.0 | -5.9 | -7.1 | -8.3 | -9.7 | -11.0 |
| EBIT | 107.4 | 14.0 | 68.2 | 112.0 | 120.4 | 116.8 | 105.0 | 110.2 |
| EBIT margin | 17.4% | 7.7% | 12.4% | 14.5% | 14.3% | 14.1% | 13.7% | 14.8% |
| Financial expenses | -1.4 | -1.9 | -8.7 | -1.1 | -1.3 | -1.3 | -1.3 | -1.2 |
| Non-operating income/costs | -2.3 | -0.3 | -1.8 | 1.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 103.7 | 11.7 | 57.7 | 112.0 | 119.1 | 115.5 | 103.7 | 108.9 |
| Tax expense | -27.8 | -2.6 | -20.1 | -27.2 | -25.0 | -21.9 | -16.6 | -17.4 |
| Net income | 75.9 | 9.2 | 37.6 | 84.9 | 94.1 | 93.5 | 87.1 | 91.5 |
| Net margin | 12.3% | 5.0% | 6.8% | 11.0% | 11.1% | 11.3% | 11.4% | 12.3% |

Balance sheet, USD mln

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Non-current assets | 48.1 | 51.7 | 67.7 | 80.6 | 98.0 | 115.2 | 130.4 | 142.3 |
| Net PP&E | 38.9 | 38.0 | 40.8 | 56.6 | 73.5 | 90.3 | 107.2 | 119.4 |
| Other | 9.2 | 13.7 | 26.9 | 24.0 | 24.5 | 24.9 | 23.2 | 22.8 |
| Current assets | 148.7 | 144.5 | 191.6 | 281.6 | 291.0 | 289.8 | 276.9 | 257.8 |
| Cash & equivalents | 7.1 | 8.2 | 45.7 | 36.0 | 52.9 | 80.1 | 98.5 | 100.4 |
| Receivables & prepayments | 50.2 | 40.1 | 26.6 | 31.9 | 37.9 | 36.2 | 33.0 | 31.4 |
| Inventories | 74.0 | 66.1 | 74.1 | 136.8 | 131.0 | 115.7 | 99.6 | 88.8 |
| Other | 17.3 | 30.1 | 45.2 | 77.0 | 69.2 | 57.8 | 45.9 | 37.2 |
| Total assets | 196.8 | 196.1 | 259.3 | 362.2 | 389.0 | 405.0 | 407.4 | 400.1 |
| Shareholder equity | 154.3 | 150.6 | 188.5 | 257.9 | 295.6 | 323.6 | 341.1 | 345.6 |
| | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-current liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| LT interest bearing debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 42.5 | 45.5 | 70.7 | 104.3 | 93.4 | 81.3 | 66.3 | 54.5 |
| Current liabilities | 11.2 | 6.0 | 7.5 | 7.2 | 7.2 | 7.2 | 7.2 | 7.2 |
| ST loans | 48.1 | 51.7 | 67.7 | 80.6 | 98.0 | 115.2 | 130.4 | 142.3 |
| Trade payables & prepayments | 20.5 | 24.2 | 44.8 | 63.9 | 54.5 | 47.2 | 37.8 | 30.2 |
| Other | 10.8 | 15.4 | 18.5 | 33.1 | 31.7 | 26.9 | 21.3 | 17.1 |
| Total liabilities & equity | 196.8 | 196.1 | 259.3 | 362.2 | 389.0 | 405.0 | 407.4 | 400.1 |

Financial ratios

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Profitability | | | | | | | | |
| ROE | 49.2% | 6.1% | 20.0% | 32.9% | 31.8% | 28.9% | 25.5% | 26.5% |
| ROA | 38.6% | 4.7% | 14.5% | 23.4% | 24.2% | 23.1% | 21.4% | 22.9% |
| ROIC | 50.3% | 7.7% | 32.0% | 37.0% | 38.2% | 37.8% | 35.4% | 36.7% |
| Liquidity | | | | | | | | |
| Current ratio | 3.5 | 3.2 | 2.7 | 2.7 | 3.1 | 3.6 | 4.2 | 4.7 |
| Quick ratio | 1.4 | 1.1 | 1.0 | 0.7 | 1.0 | 1.4 | 2.0 | 2.4 |
| Cash ratio | 0.2 | 0.2 | 0.6 | 0.3 | 0.6 | 1.0 | 1.5 | 1.8 |
| Turnover | | | | | | | | |
| Days receivable | 30 | 80 | 18 | 15 | 16 | 16 | 16 | 15 |
| Days inventory | 57 | 152 | 60 | 82 | 70 | 63 | 58 | 54 |
| Days payable | 16 | 56 | 36 | 39 | 29 | 26 | 22 | 18 |
| Cash conversion cycle | 71 | 177 | 41 | 59 | 57 | 53 | 52 | 51 |
| Solvency | | | | | | | | |
| LT debt/Equity | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net debt/Equity | 0.03 | -0.01 | -0.20 | -0.11 | -0.15 | -0.23 | -0.27 | -0.27 |
| Financial leverage | 0.07 | 0.04 | 0.04 | 0.03 | 0.02 | 0.02 | 0.02 | 0.02 |
| Interest coverage | 76.3 | 7.3 | 7.8 | 100.9 | 92.6 | 89.8 | 83.0 | 89.7 |
| Per share | | | | | | | | |
| EPS | 0.66 | 0.08 | 0.33 | 0.74 | 0.82 | 0.82 | 0.76 | 0.80 |
| DPS | 0.09 | 0.01 | 0.07 | 0.15 | 0.49 | 0.57 | 0.61 | 0.76 |

Source: Company data, Concorde Capital

STAKHANIV WAGON

Diversified on the upstream

Only producer with diversified spare parts supplies

As the only Ukrainian wagon maker supplying its bogie casting from the EU, Stakhaniv is set to avoid periodic restrictions in exports to Russia due to the quality issues of Ukrainian-made casting. The company benefits from the bogie castings deficit, which forces its competitors to cut output and allows Stakhaniv to skim the cream off of the all-time high demand for freight railcars in 2012.

Sales are backed by its parent holding

Owned by Ferrexpo's majority shareholder, Stakhaniv Wagon receives a steady flow of orders for new freight cars from the related iron ore producer (600 units in 2012 and 500 in 2013). Exporting only 61% of its output in 1Q12 (vs. 80-90% for other domestic wagon producers), the company has the best geographically diversified sales structure among its local peers, which makes it more resilient to possible Russian export limits.

Transfer pricing – the key risk to profitability

Stakhaniv Wagon has historically been one of the least profitable Ukrainian wagon producers. We expect that being able to control its Czech producer's casting parts prices, Stakhaniv's parent group will target a flat gross margin for the company, with no significant improvements in foreseeable future.

Company description

Stakhaniv Wagon is a pure freight railcar producer. The company designs and manufactures gondola cars, hoppers, platforms and dump cars, as well as cars of unique specifications (e.g. for oversized loads and nuclear fuel). Its supplementary business is a steelworks division that provides heavy steel fabrication and custom-designed welded materials.

Selected financials and ratios

| | 2010 | 2011 | Chg, yoy | 2012E | Chg, yoy |
|----------------------------|-------|-------|----------|-------|----------|
| Net revenue | 363 | 436 | 20.1% | 478 | 9.6% |
| Gross margin, % | 13.8% | 10.4% | 3.4pp | 10.2% | -0.2pp |
| EBITDA | 37 | 33 | -9.9% | 37 | 10.3% |
| EBITDA margin, % | 10.1% | 7.6% | 2.5pp | 7.7% | 0.0pp |
| Net income | 33 | 20 | -39.4% | 22 | 9.8% |
| Net margin, % | 9.0% | 4.6% | 4.4pp | 4.6% | 0.0pp |
| PP&E, net | 29 | 33 | 13.2% | 48 | 45.1% |
| Shareholder equity | 81 | 100 | 23.8% | 118 | 17.4% |
| LT debt | 38 | 54 | 44.3% | 29 | -46.6% |
| ST debt | 17 | 0 | -100.0% | 25 | n.a. |
| Total liabilities & equity | 249 | 235 | -5.5% | 235 | -0.1% |
| CapEx | 6 | 8 | 33.3% | 18 | 114.3% |
| Current ratio | 1.4 | 1.6 | 17.1% | 1.5 | -11.3% |
| Net debt/Equity | -0.4 | 0.0 | -108.7% | -0.1 | -431.8% |
| ROA | 9.9% | 5.9% | -4.0pp | 6.2% | 0.3pp |
| ROE | 40.5% | 19.8% | -20.7pp | 18.5% | -1.3pp |
| ROIC | 71.7% | 23.2% | -48.5pp | 26.4% | 3.2pp |

Source: Company Data, Concorde Capital

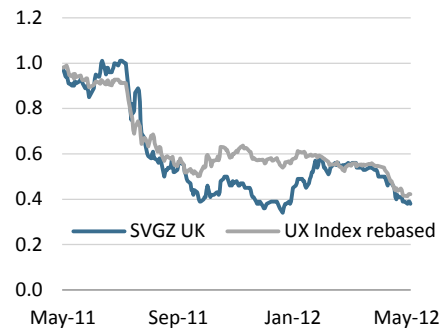
Operations

| | 2010 | 2011 | Chg, yoy | 2012E | Chg, yoy |
|---------------------------|-------|-------|----------|-------|----------|
| Freight wagons production | 7,334 | 6,810 | -7.1% | 7,014 | 3.0% |

Source: Company data, Concorde Capital

SVGZ UK Current: USD 0.38 [BUY]
Target: USD 0.74

Share price performance*



* Hereafter, share prices as of May 31, 2012

Source: Bloomberg

Market data

| Bloomberg | SVGZ UK |
|--------------------------------|---------|
| Current price, USD | 0.38 |
| MCap, USD mln | 86.8 |
| Net Debt, USD mln | 3.8 |
| EV, USD mln | 90.5 |
| Free float, % | 7.8% |
| Free float, USD mln | 6.8 |
| Common shares outstanding, mln | 226.4 |
| Change from 52W low, % | 11.7% |
| Change from 52W high, % | -62.3% |
| 1M change, % | -24.0% |
| 3M change, % | -29.6% |
| 12M change, % | -61.2% |

Source: Bloomberg

Ownership structure

| | |
|------------------------|-------|
| Finance & Credit Group | 92.2% |
| Free float | 7.8% |

Source: Company data, Concorde Capital

Multiples and per-share data

| | 2010 | 2011 | 2012E |
|--------------------|-------|-------|-------|
| EV/Output, USD ths | 12.34 | 13.29 | 12.91 |
| EV/Sales | 0.25 | 0.21 | 0.19 |
| EV/EBITDA | 2.46 | 2.73 | 2.47 |
| P/E | 2.69 | 4.44 | 4.04 |
| P/B | 0.27 | 0.26 | 0.25 |
| BPS, USD | 0.36 | 0.44 | 0.52 |
| EPS, USD | 0.15 | 0.09 | 0.10 |
| DPS, USD | 0.00 | 0.00 | 0.02 |

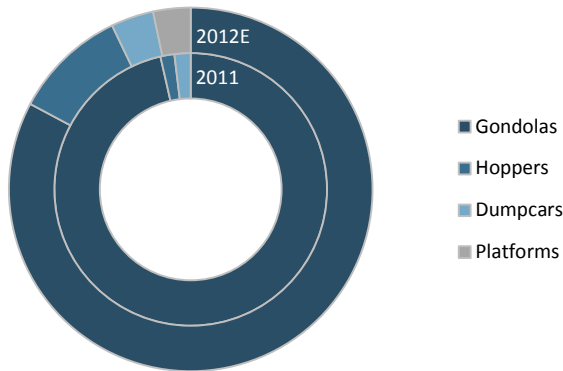
Source: Bloomberg, Company data, Concorde Capital

Company overview

Pure freight wagon producer concentrated on gondolas

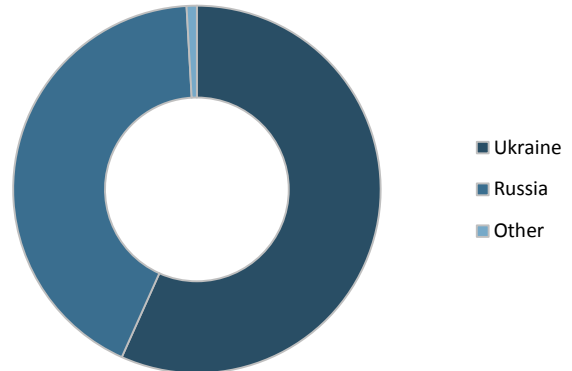
Stakhaniv Wagon is the #6 CIS freight railcar producer (6% share in terms of 2011 sales). The company is capable of making a wide range of freight railcars, including specialized dump cars and schnabel cars, which are used for the transportation of heavy oversized loads and nuclear fuel. Consistently high demand for gondola cars in the CIS in recent years has allowed the company to focus on this type of wagons. Gondola cars accounted for ~97% of the company's 2011 output (6,608 units). The company sold more than 50% of its output in Ukraine last year and therefore was less dependent on the Russian market.

Stakhaniv's sales structure



Source: Company data, PG-Online, Concorde Capital

Sales by region, 2011



Source: Company data

Casting self-sufficiency makes Stakhaniv Wagon a perfect short-term play

Stakhaniv is best protected among Ukrainian wagon makers from possible Russian regulatory bans on the use of domestically-made casting parts. The company can satisfy up to 2/3 of its casting needs from inside the group (450 casting wagon sets monthly) after its parent acquired Czech casting producer CKD Kutna Hora in February 2012. This potentially allows the company to win some orders from competitors who might struggle to meet their orders due to possible casting bans. So, any short-term bans on Ukrainian casting by Russia could benefit Stakhaniv. The dark side of this kind of vertical integration is the risk of transfer pricing.

Transfer pricing is a key concern

Casting supplies from a related party clearly protect Stakhaniv from any sharp increases in spare part prices. At the same time, the tension between current ruling regime in Ukraine and Stakhaniv's major shareholder, Konstantin Zhevago (a supporter of jailed opposition politician Yulia Tymoshenko), increase the incentive to allocate more profits outside of Ukraine via transfer pricing. We expect that in spite of 10% yoy growth in the company's EBITDA, its margin will remain flat at 7.7% and will remain the lowest among its local competitors.

SWOT

| Strengths | Weaknesses/Limitations |
|--|--|
| Availability of alternative sources of bogie castings Support of its parent group Geographically-diversified sales | Concentration on a single type of freight wagon Limited ability to hedge an increase in raw materials costs |
| Opportunities | Threats |
| Increase in order flow after the reform of Ukrzaliznytsya Ability to produce custom dump cars and schnabel cars | New players entering the market Expansion of production capacity by existing competitors Saturation of Russian freight railcar market in 2013/2014 Risk of transfer pricing |

Source: Concorde Capital

Outlook for growth

Wagon output to grow on casting supplies from Kutna Hora in 2012

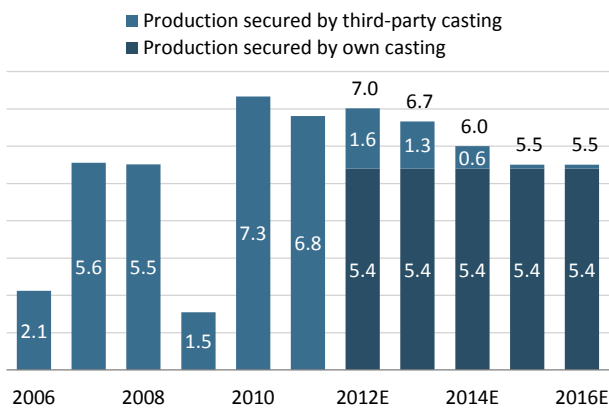
Related Kutna Hora can supply about 5,400 casting wagon sets to Stakhaniv in 2012, or 67% of what is necessary to meet the company’s total wagon output plan of 8,090 units.

The company’s production target for 2012 suggests it will buy at least 200-250 sets in Kremenchuk each month. Acknowledging the risk of a new short-term bans of Kremenchuk-made casting from Russia, we estimate Stakhaniv will produce only 7,000 freight cars in 2012 (up 3% yoy). We expect sales will increase 9.6% yoy to USD 478 mln. The inflated bogie casting price will inhibit growth in Stakhaniv’s profitability, leaving its EBITDA margin flat at 7.7% in 2012, while the 10% yoy growth in the company’s EBITDA to USD 36 mln will be driven by a proportional increase in sales.

Mid-term demand decline to be offset by higher value-added products

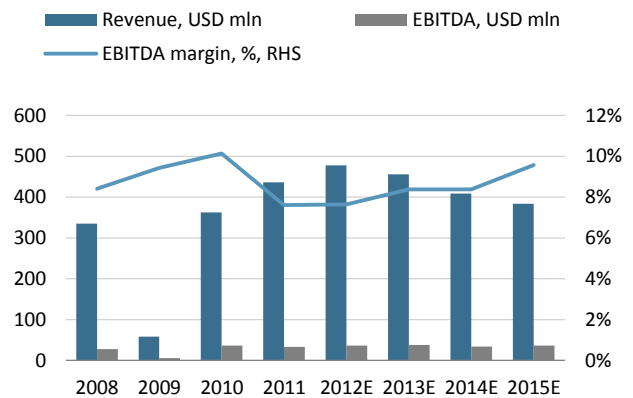
The company will face a gradual decline in demand for new gondola wagons in 2013-2015, but its concentration on other higher value-added freight railcars will allow Stakhaniv to improve its profitability, even faced with a drop in output and sales.

Stakhaniv freight railcars annual production, ths units



Source: Company data, Concorde Capital

Revenues and profitability



Source: Company data, Concorde Capital

Parent holding is supporting Stakhaniv’s sales

Apart from the acquisition of the Czech foundry to strengthen the vertical integration of its wagon building business, Stakhaniv’s parent holding Finance & Credit will also support a steady flow of orders for the company in 2012 and on.

Ferrexpo, also owned by the same majority shareholder as Stakhaniv, announced plans to order 600 railcars from Stakhaniv Wagon in 2012. This order would bring the company USD 40.8 mln in sales, representing 8.5% of its full-year revenue. Another 500 wagons will be supplied to Ferrexpo in 2013-2014 under an option agreement signed in April 2012.

Financial performance

Control over Kutna Hora prevents hikes in production costs

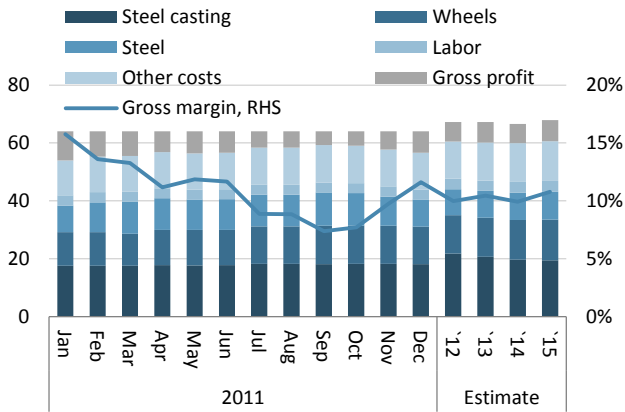
The subordination of the Kutna Hora plant’s pricing policy to Stakhaniv’s parent holding should stabilize the costs of materials and protect it from sudden prices hikes, as it experienced in 1Q12.

For instance, Stakhaniv did not buy bogie casting from Kremenchuk Steel Casting in 1Q12 when the supplier reportedly raised its prices by 50% in one quarter. Otherwise, the company’s gross margin would have fallen to zero.

Profitability remains the lowest among local peers

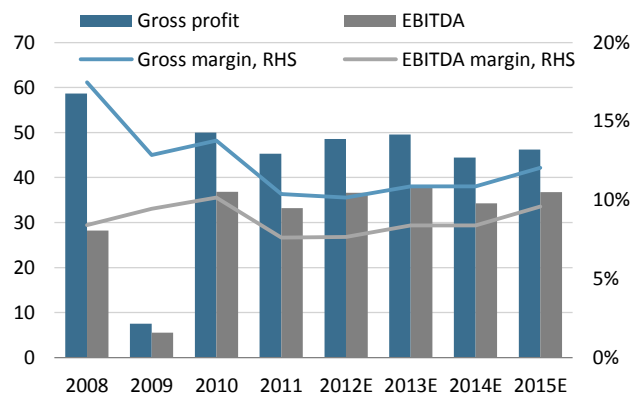
Historically, Stakhaniv Wagon has been one of the least profitable Ukrainian wagon makers, and we do not expect the situation to change much this year. We expect the company’s gross profit will grow 7% yoy, mainly driven by a comparable increase in sales. We thus expect the parent group will target a flat gross margin for the company by controlling for Czech casting part prices. In particular, this year we anticipate the company’s gross margin will remain 10.2% (almost 2x lower compared to Kryukiv Wagon). The company’s EBITDA will follow revenues and grow 10% yoy, with a margin of 7.7% in 2012.

Stakhaniv’s average freight railcar costs breakdown, USD ths



Source: Company data, Concorde Capital

Profitability, USD mln

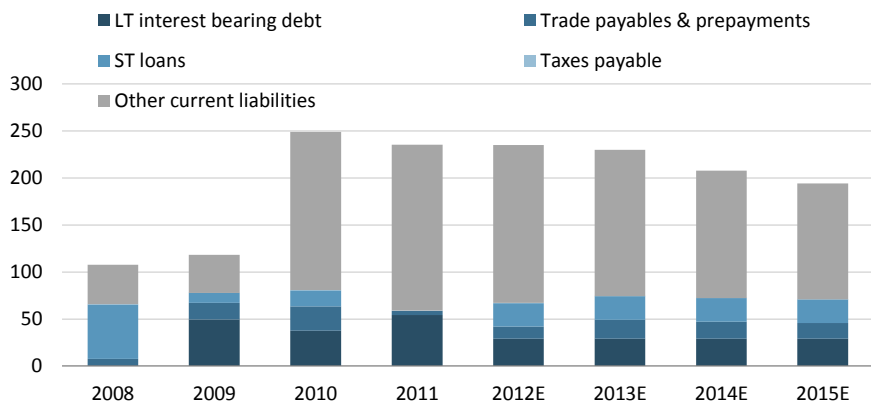


Source: Company data, Concorde Capital

Non-transparent liabilities structure

According to reported financials, Stakhaniv’s liabilities consist mainly of “Other current liabilities”, which most likely are due to related parties. The share of payables & prepayments on its balance sheet is low compared to some of its peers who claim up to 100% prepayments.

Stakhaniv’s liabilities breakdown

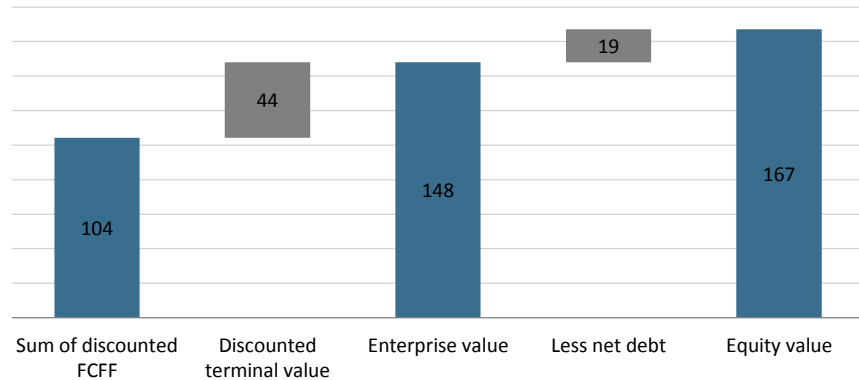


Source: Company data, Concorde Capital

Valuation

We assign a 12M target price of USD 0.74 for Stakhaniv Wagon shares based on DCF. This implies 93% upside. We initiate coverage with a BUY recommendation.

Stakhaniv Wagon DCF valuation summary, USD mln



Source: Concorde Capital

Operating model assumptions for Stakhaniv Wagon

Wagons output, units

| | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|---------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Hoppers | 110 | 700 | 800 | 900 | 1000 | 1000 | 1000 | 1000 | 1000 | 1000 |
| Gondolas | 6,608 | 5,924 | 5,434 | 4,607 | 3,990 | 3,990 | 3,990 | 3,990 | 3,990 | 3,990 |
| Dump cars | 92 | 190 | 210 | 250 | 250 | 250 | 250 | 250 | 250 | 250 |
| Platforms | 0 | 200 | 220 | 240 | 260 | 260 | 260 | 260 | 260 | 260 |
| Total freight cars | 6,810 | 7,014 | 6,664 | 5,997 | 5,500 | 5,500 | 5,500 | 5,500 | 5,500 | 5,500 |
| <i>yoy change</i> | n/a | 3% | -5% | -10% | -8% | 0% | 0% | 0% | 0% | 0% |

Source: Company data, Concorde Capital

Price, USD ths/wagon

| | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|-----------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Hoppers | 65 | 68 | 68 | 68 | 69 | 70 | 72 | 73 | 75 | 76 |
| Gondolas | 63 | 66 | 66 | 65 | 67 | 68 | 69 | 71 | 72 | 74 |
| Dump cars | 90 | 95 | 95 | 94 | 95 | 97 | 99 | 101 | 103 | 105 |
| Platforms | 75 | 79 | 79 | 78 | 80 | 81 | 83 | 84 | 86 | 88 |

Source: Company data, Concorde Capital

Key cost components, USD ths/wagon

| | 2011 | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|-------------------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Steel casting | 17.9 | 21.5 | 20.4 | 19.4 | 19.2 | 19.6 | 19.9 | 20.3 | 20.7 | 21.2 |
| <i>yoy change</i> | n/a | 20% | -5% | -5% | -1% | 2% | 2% | 2% | 2% | 2% |
| Wheels | 12.4 | 12.6 | 12.9 | 13.1 | 13.4 | 13.7 | 13.9 | 14.2 | 14.5 | 14.8 |
| <i>yoy change</i> | n/a | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% |
| Steel | 10.6 | 10.3 | 10.5 | 10.7 | 10.9 | 11.1 | 11.3 | 11.6 | 11.8 | 12.1 |
| <i>yoy change</i> | n/a | -3% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% |
| Salaries, wages and related charges | 3.5 | 3.6 | 3.6 | 3.7 | 3.8 | 3.9 | 3.9 | 4.0 | 4.1 | 4.2 |
| <i>yoy change</i> | n/a | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 2% |

Source: Company data, Concorde Capital

Discount rate and perpetuity assumptions

We apply a 20.5% cost of equity for valuation purposes, which encompasses a 5% company-specific premium, which we apply to account for business risks (raw materials supply) and stock liquidity. We apply a 1% perpetuity growth rate assumption and WACC in perpetuity at 17.5%.

WACC decomposition

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---------------------------|--------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Gov't eurobond yield | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% | 9.5% |
| Equity premium | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Company-specific premium | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% |
| Cost of equity | 20.5% | 20.5% | 20.5% | 20.5% | 20.5% | 20.5% | 20.5% | 20.5% | 20.5% | 20.5% |
| Cost of debt (after tax) | 7.9% | 7.9% | 8.1% | 8.4% | 8.4% | 8.4% | 8.4% | 8.4% | 8.4% | 8.4% |
| D/E | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Share of equity | 0.65 | 0.69 | 0.71 | 0.73 | 0.74 | 0.74 | 0.75 | 0.75 | 0.75 | 0.75 |
| WACC | 16.1% | 16.5% | 16.9% | 17.2% | 17.3% | 17.4% | 17.4% | 17.5% | 17.5% | 17.5% |
| WACC To Perpetuity | 17.5% | | | | | | | | | |

Source: Company data, Concorde Capital

Discounted cash flow model

USD mln, unless other specified

| | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------------------------|-------|
| EBIT | 33.1 | 34.1 | 29.6 | 31.7 | 32.2 | 32.8 | 33.5 | 34.3 | 34.7 | 35.2 |
| - Tax expense | -5.8 | -5.5 | -3.9 | -4.2 | -4.3 | -4.4 | -4.5 | -4.6 | -4.7 | -4.8 |
| Effective tax rate, % | 23% | 21% | 19% | 16% | 16% | 16% | 16% | 16% | 16% | 16% |
| - Tax shield on interests | -1.1 | -1.0 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 |
| + D&A | 3.5 | 4.1 | 4.6 | 5.1 | 5.4 | 5.4 | 5.5 | 5.5 | 5.6 | 5.5 |
| - CapEx | -18.0 | -18.0 | -17.0 | -13.0 | -5.4 | -5.5 | -5.5 | -5.6 | -5.6 | -5.6 |
| - Increase in working capital | 15.5 | 8.8 | 1.7 | 0.9 | -4.7 | -4.9 | -1.0 | -1.0 | -1.2 | -1.2 |
| FCFF | 27.1 | 22.6 | 14.2 | 19.6 | 22.3 | 22.6 | 27.2 | 27.8 | 27.9 | 28.3 |
| WACC | | 16.9% | 17.2% | 17.3% | 17.4% | 17.4% | 17.5% | 17.5% | 17.5% | 17.5% |
| Discount factor | | 0.91 | 0.78 | 0.66 | 0.56 | 0.48 | 0.41 | 0.35 | 0.30 | 0.25 |
| Discounted FCFF @ May-31-2013 | | 20.6 | 11.0 | 13.0 | 12.6 | 10.9 | 11.1 | 9.7 | 8.3 | 7.1 |
| Terminal value (TV) | | | | | | | | | | 173.4 |
| | | | | | | | | | Implied EBITDA multiple | 4.3 x |
| | | | | | | | | | TV as % of EV | 30% |
| Sum of discounted FCFFs | | | 104.2 | | | | | | | |
| TV @ 31-May-2013 | | | 43.8 | | | | | | | |
| Enterprise value | | | 148.0 | | | | | | | |
| Less net debt | | | 19.1 | | | | | | | |
| Equity value | | | 167.1 | | | | | | | |
| Value per share, USD | | | 0.7 | | | | | | | |
| Terminal value assumptions: | | | | | | | | | | |
| Perpetuity growth rate | | | 1.0% | | | | | | | |
| WACC in perpetuity | | | 17.5% | | | | | | | |

Source: Company data, Concorde Capital

Sensitivity tables, USD per share

| WACC | Perpetuity Growth Rate | | | | | WACC | Exit Multiple (EBITDA) | | | | |
|-------|------------------------|------|------|------|------|------|------------------------|-------|-------|-------|-------|
| | 0.0% | 0.5% | 1.0% | 1.5% | 2.0% | | 3.3 x | 3.8 x | 4.3 x | 4.8 x | 5.3 x |
| 15.5% | 0.75 | 0.76 | 0.76 | 0.77 | 0.78 | 2.0% | 0.75 | 0.78 | 0.80 | 0.83 | 0.85 |
| 16.5% | 0.74 | 0.74 | 0.75 | 0.76 | 0.77 | 1.0% | 0.72 | 0.74 | 0.77 | 0.79 | 0.82 |
| 17.5% | 0.73 | 0.73 | 0.74 | 0.75 | 0.75 | 0.0% | 0.69 | 0.72 | 0.74 | 0.76 | 0.78 |
| 18.5% | 0.72 | 0.72 | 0.73 | 0.73 | 0.74 | 1.0% | 0.67 | 0.69 | 0.71 | 0.73 | 0.75 |
| 19.5% | 0.71 | 0.71 | 0.72 | 0.72 | 0.73 | 2.0% | 0.64 | 0.66 | 0.68 | 0.70 | 0.72 |

Source: Concorde Capital

Financials

Income statement, USD mln

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E |
|----------------------------|--------------|-------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Net revenue | 335.6 | 58.7 | 363.0 | 436.1 | 478.1 | 455.7 | 408.7 | 383.8 |
| Gross profit | 58.6 | 7.5 | 50.0 | 45.3 | 48.5 | 49.5 | 44.4 | 46.2 |
| Gross margin | 17.5% | 12.9% | 13.8% | 10.4% | 10.2% | 10.9% | 10.9% | 12.0% |
| EBITDA | 28.2 | 5.5 | 36.8 | 33.2 | 36.6 | 38.2 | 34.3 | 36.8 |
| EBITDA margin | 8.4% | 9.4% | 10.1% | 7.6% | 7.7% | 8.4% | 8.4% | 9.6% |
| D&A | -3.2 | -2.7 | -3.0 | -3.2 | -3.5 | -4.1 | -4.6 | -5.1 |
| EBIT | 25.0 | 2.8 | 33.8 | 30.0 | 33.1 | 34.1 | 29.6 | 31.7 |
| EBIT margin | 7.4% | 4.8% | 9.3% | 6.9% | 6.9% | 7.5% | 7.3% | 8.3% |
| Financial expenses | -9.1 | -10.9 | -8.4 | -5.6 | -5.4 | -5.4 | -5.4 | -5.4 |
| Non-operating income/costs | 2.2 | 0.9 | 7.9 | 1.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 18.1 | -7.2 | 33.4 | 25.7 | 27.7 | 28.7 | 24.2 | 26.3 |
| Tax expense | 0.0 | 0.0 | -0.6 | -5.8 | -5.8 | -5.5 | -3.9 | -4.2 |
| Net income | 18.1 | -7.2 | 32.8 | 19.9 | 21.9 | 23.3 | 20.4 | 22.1 |
| Net margin | 5.4% | -12.2% | 9.0% | 4.6% | 4.6% | 5.1% | 5.0% | 5.8% |

Balance sheet, USD mln

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Non-current assets | 30.5 | 31.0 | 33.3 | 38.2 | 52.7 | 67.0 | 79.4 | 87.5 |
| Net PP&E | 27.5 | 26.5 | 29.1 | 33.0 | 47.8 | 62.2 | 75.9 | 85.0 |
| Other | 3.0 | 4.5 | 4.2 | 5.2 | 4.9 | 4.8 | 3.5 | 2.6 |
| Current assets | 114.5 | 135.7 | 297.0 | 297.6 | 300.3 | 297.3 | 274.9 | 257.8 |
| Cash & equivalents | 1.8 | 60.5 | 89.7 | 50.5 | 68.7 | 79.5 | 81.0 | 78.1 |
| Receivables & prepayments | 35.8 | 34.7 | 141.8 | 172.8 | 160.3 | 150.3 | 133.6 | 123.4 |
| Inventories | 20.4 | 13.3 | 8.9 | 36.5 | 29.7 | 27.8 | 24.8 | 22.9 |
| Other | 56.4 | 27.2 | 56.5 | 37.8 | 41.6 | 39.7 | 35.6 | 33.4 |
| Total assets | 145.0 | 166.7 | 330.3 | 335.8 | 353.0 | 364.3 | 354.3 | 345.3 |
| Shareholder equity | 37.1 | 48.5 | 81.2 | 100.5 | 118.0 | 134.3 | 146.5 | 150.9 |
| | 0.0 | 49.7 | 37.6 | 54.3 | 29.0 | 29.0 | 29.0 | 29.0 |
| Non-current liabilities | 0.0 | 49.7 | 37.6 | 54.3 | 29.0 | 29.0 | 29.0 | 29.0 |
| LT interest bearing debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 107.9 | 68.6 | 211.5 | 181.0 | 206.0 | 201.0 | 178.8 | 165.4 |
| Current liabilities | 58.1 | 10.6 | 17.3 | 0.0 | 25.0 | 25.0 | 25.0 | 25.0 |
| ST loans | 30.5 | 31.0 | 33.3 | 38.2 | 52.7 | 67.0 | 79.4 | 87.5 |
| Trade payables & prepayments | 7.6 | 17.4 | 25.7 | 4.6 | 12.9 | 20.3 | 18.2 | 16.9 |
| Other | 42.2 | 40.6 | 168.4 | 176.5 | 168.1 | 155.7 | 135.6 | 123.5 |
| Total liabilities & equity | 145.0 | 166.7 | 330.3 | 335.8 | 353.0 | 364.3 | 354.3 | 345.3 |

Financial ratios

| | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E | 2015E |
|-----------------------|-------|--------|-------|-------|-------|-------|-------|-------|
| Profitability | | | | | | | | |
| ROE | 48.6% | -14.8% | 40.5% | 19.8% | 18.5% | 17.3% | 13.9% | 14.6% |
| ROA | 12.5% | -4.3% | 9.9% | 5.9% | 6.2% | 6.4% | 5.7% | 6.4% |
| ROIC | 26.7% | 5.9% | 71.7% | 23.2% | 26.4% | 26.4% | 21.6% | 21.7% |
| Liquidity | | | | | | | | |
| Current ratio | 1.1 | 2.0 | 1.4 | 1.6 | 1.5 | 1.5 | 1.5 | 1.6 |
| Quick ratio | 0.3 | 1.4 | 1.1 | 1.2 | 1.1 | 1.1 | 1.2 | 1.2 |
| Cash ratio | 0.0 | 0.9 | 0.4 | 0.3 | 0.3 | 0.4 | 0.5 | 0.5 |
| Turnover | | | | | | | | |
| Days receivable | 39 | 216 | 143 | 145 | 122 | 120 | 119 | 117 |
| Days inventory | 57 | 152 | 60 | 82 | 70 | 63 | 58 | 54 |
| Days payable | 16 | 56 | 36 | 39 | 29 | 26 | 22 | 18 |
| Cash conversion cycle | 80 | 313 | 166 | 189 | 163 | 157 | 155 | 153 |
| Solvency | | | | | | | | |
| LT debt/Equity | 0.00 | 1.02 | 0.46 | 0.54 | 0.25 | 0.22 | 0.20 | 0.19 |
| Net debt/Equity | 1.52 | 0.00 | -0.43 | 0.04 | -0.12 | -0.19 | -0.18 | -0.16 |
| Financial leverage | 1.57 | 1.24 | 0.68 | 0.54 | 0.46 | 0.40 | 0.37 | 0.36 |
| Interest coverage | 2.7 | 0.3 | 4.0 | 5.4 | 6.1 | 6.3 | 5.5 | 5.9 |
| Per share | | | | | | | | |
| EPS | 0.08 | -0.03 | 0.15 | 0.09 | 0.10 | 0.10 | 0.09 | 0.10 |
| DPS | - | - | - | - | 0.02 | 0.03 | 0.04 | 0.08 |

Source: Company data, Concorde Capital

Analyst certification

We, Roman Dmytrenko and Alexander Paraschiy, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Kryukiv Wagon: Rating history

| Date | 12M target price, USD | Market price, USD | Rating | Action |
|--------------|-----------------------|-------------------|--------|------------|
| 01-June-2012 | 5.03 | 2.10 | Buy | Initiating |

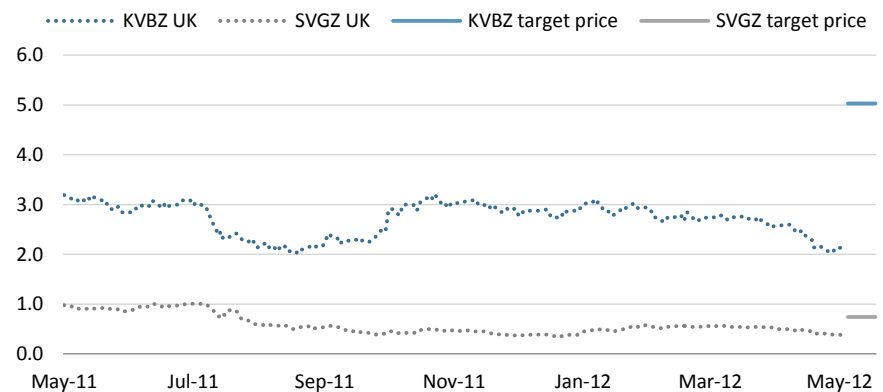
Source: Concorde Capital

Stakhaniv Wagon: Rating history

| Date | 12M target price, USD | Market price, USD | Rating | Action |
|--------------|-----------------------|-------------------|--------|------------|
| 01-June-2012 | 0.74 | 0.38 | Buy | Initiating |

Source: Concorde Capital

Company: Target price vs. share performance, USD per share



Source: Bloomberg, Concorde Capital

Investment ratings

The time horizon for target prices in Concorde Capital's research is 12 months unless otherwise stated. Concorde Capital employs three basic investment ratings: Buy, Hold and Sell. Typically, Buy recommendation is associated with an upside of 20% or more from the current market price; Sell is prompted by downside from the current market price (upside <0%); Hold recommendation is generally for limited upside within 20%. Though investment ratings are generally induced by the magnitude of upside, they are not derived on this basis alone. In certain cases, an analyst may have reasons to establish a recommendation where the associated range given above does not correspond. Temporary discrepancies between an investment rating and its upside at a specific point in time due to price movement and/or volatility will be permitted; Concorde Capital may revise an investment rating at its discretion. A recommendation and/or target price might be placed Under Review when impelled by corporate events, changes in finances or operations. Investors should base decisions to Buy, Hold or Sell a stock on the complete information regarding the analyst's views in the research report and on their individual investment objectives and circumstances.

Contacts

CONCORDE CAPITAL
 2 Mechnikova Street, 16th Floor
 Parus Business Centre
 Kyiv 01601, Ukraine
 Tel.: +380 44 391 5577
 Fax: +380 44 391 5571
 www.concorde.ua
 Bloomberg: TYPE CONR <GO>

CEO

Igor Mazepa

im@concorde.com.ua

SALES

International Sales & Trading

Katerina Shevchenko
 Marina Martirosyan
 Rostyslav Shmanenko

ksh@concorde.com.ua
 mm@concorde.com.ua
 rs@concorde.com.ua

RESEARCH

Head of Research

Alexander Paraschiy ap@concorde.com.ua

Agriculture, Consumer

Yegor Samusenko syg@concorde.com.ua

Machinery

Roman Dmytrenko rd@concorde.com.ua

Utilities, Telecommunications

Alexander Paraschiy ap@concorde.com.ua

Economics, Fixed income, Energy

Vitaliy Vavryshchuk vv@concorde.com.ua

Metals & Mining

Roman Topolyuk rt@concorde.com.ua

Financials

Olena Zuikova olz@concorde.com.ua

Corporate governance, Politics

Brad Wells bw@concorde.com.ua

Editor

Brad Wells bw@concorde.com.ua

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