



CONCORDE CAPITAL

Ukraine / Oil & Gas

Ukrnafta

To Drill or Not to Drill?

March 07, 2007

12M Target: USD 56.0

HOLD

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Market information

Bloomberg	UNAF UZ
Frankfurt/Xetra	UKAA GR
No of Shares, mln	54.2
Reg S GDR to Ord.	1:6
Market price, USD	66.0
52Wk H/L, USD	78.2/55.3
MCap, USD mln	3,579.3
Free float	8%
FF MCap, USD mln	286.3

Mo avg tr volume*, USD mln 7.6

Note: 6M trailing, PFTS & Frankfurt

Stock ownership

State	50%+1
Privat Group	42%
Other	8%

Ratios, 9MO6

EBITDA Margin	47.1%
EBIT Margin	40.6%
Net Margin	29.1%
Net Debt/Equity	0.12

Ukrnafta's management seems to be pushing state authorities to cut back oil and gas royalties with its threats to stop production at its least profitable fields, which account for some 11.5% of the company's 2007E sales. We don't think that UNAF's supervisory board, with a majority controlled by the state, will approve production cuts. We expect the issue to remain unresolved for at least a few months; whatever the compromise will be, now it is hardly predictable. We maintain our target and recommendation.

Privat asks supervisory board to approve production cuts

Ukrnafta's management, which is controlled by Privat Group, requested yesterday that its supervisory board approve production cuts at its oil and gas fields in western Ukraine. Earlier this year, the company said that it will stop operations at some of its fields if the state does not roll back a 2007 royalty increase that "has made extraction from depleted fields unprofitable." Ukrnafta's management warned that production cuts will result in a decrease of oil and gas output by 500 ths mt (3.6 mln bbl) and 250-mcm respectively, which we estimate is equivalent to ~11.5% of 2007 projected revenue.

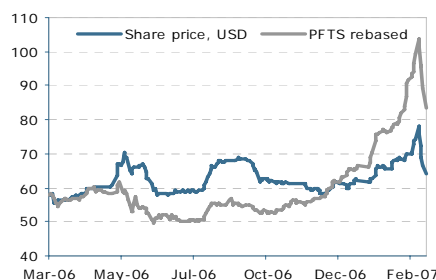
Board unlikely to assent

We don't believe it will be easy for Ukrnafta to prove that it incurs a loss even at the most depleted fields where operating costs are unlikely to exceed USD 5/bbl, while Ukrnafta's oil price netted for royalty tax and VAT is close to USD 25/bbl. We also don't think that Ukrnafta's supervisory board, with the majority of votes controlled by the state-run Naftogaz Ukrainy, will approve production cuts. Neither Naftogaz management nor Fuel and Energy Minister Yuriy Boiko who supervises Naftogaz, will take on responsibility for such a politically-sensitive decision.

Lower royalty or a corporate conflict?

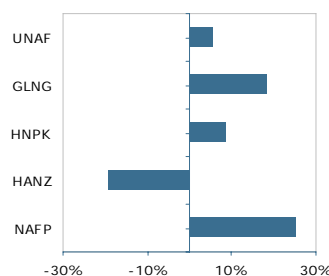
The government might react to Ukrnafta's demands by decreasing royalties or doing some other favors; or it might decide to fight with Privat Group, which will result in a corporate conflict and might lead to production cuts. The first option is positive for Ukrnafta's valuation, while the second is definitely negative. So far, we believe there are few reasons to factor the royalty decrease [positive] or production cuts [negative] into Ukrnafta's valuation and maintain our target and recommendation unchanged.

UNAF stock performance

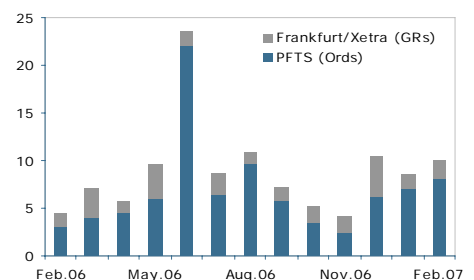


Source: PFTS, Bloomberg

Sector performance, YTD



Trading volume, USD mln



Key financials & ratios

(in USD mln)	Sales	EBITDA Margin	Net Margin	EV/S	EV/EBITDA	P/E
2005	1 087.9	53.9%	33.5%	3.18	5.91	9.28
2006E	1 701.9	41.4%	25.3%	2.05	4.95	7.86
2007E	2 052.6	30.2%	16.8%	1.78	5.87	9.84

Spot exchange rate: 5.05

Appendix

Ukrnafta oil and gas production, 2005-2007E

	2005	2006	*2007E	Possible production cuts	2007E including production cuts
Oil & condensate, mln bbl	23.1	23.6	23.9	-3.7	20.2
% growth, yoy		2.2%	1.3%		-14.4%
Natural and oil gas, mln boe	20.4	20.8	21.4	-1.6	19.9
% growth, yoy		1.8%	3.1%		-4.4%

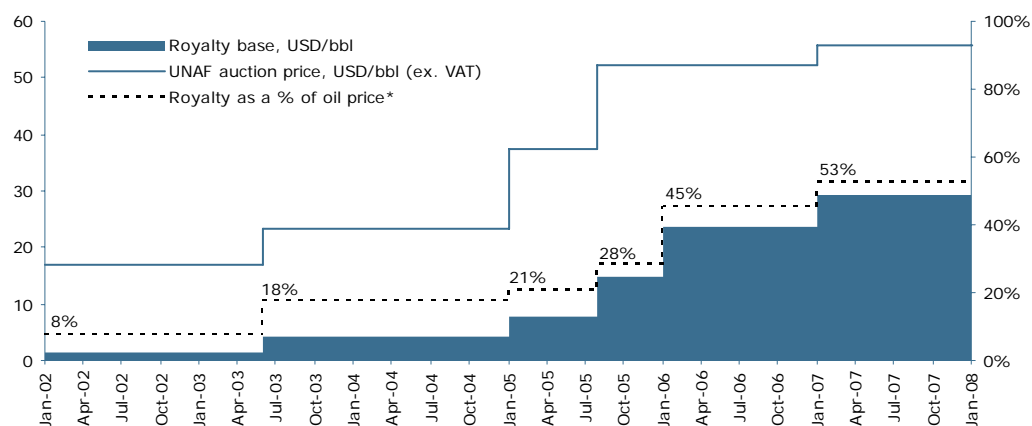
Source: Company data, Concorde Capital estimates

Effect of production cuts on oil & gas output and revenues

	Output change, mln bbl (boe)	2007E avg. price, USD/bbl (boe)	Value, USD mln	Share in 2007E sales, % (abs.)
Oil & condensate	-3.7	55.9	206.9	10.1%
Natural and oil gas	-1.6	19.0	29.7	1.4%
Total			236.6	11.5%

Source: Company data, Concorde Capital estimates

Oil royalty and UNAF auction prices



Note: The royalty base was used; the effective royalty depends on the auction price and the price of oil imported from Russia (see our report from September 2006).

Source: State budget law, Interfax, Ukrainian News

Ukrnafta P&L summary*, USD mln

	2005	2006E	**2007E	2008E	2009E	2010E
Net Revenues	1,088	1,702	2,053	2,538	3,184	3,893
Gross profit	691	824	768	845	924	1,014
Gross margin	63.5%	48.4%	37.4%	33.3%	29.0%	26.0%
EBITDA	586	704	622	663	692	726
EBITDA margin	53.9%	41.4%	30.3%	26.1%	21.7%	18.6%
Depreciation	(100)	(128)	(152)	(175)	(196)	(215)
EBIT	486	576	470	488	496	511
EBIT margin	44.7%	33.8%	22.9%	19.2%	15.6%	13.1%
Interest expense	(11)	(12)	(22)	(32)	(42)	(48)
Financial income/(expense)	24	24	24	24	24	24
Other income/(expense)	(13)	(13)	(13)	(13)	(13)	(13)
PBT	486	575	459	466	465	473
Tax	(121)	(144)	(115)	(117)	(116)	(118)
Effective tax rate	25%	25%	25%	25%	25%	25%
Net Income	365	431	344	350	349	355
Net margin	33.5%	25.3%	16.8%	13.8%	10.9%	9.1%

* Last forecast revision date: Sep. 21, 2006

** No production cuts assumed

Source: Company data, Concorde Capital estimates

Analyst certification

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

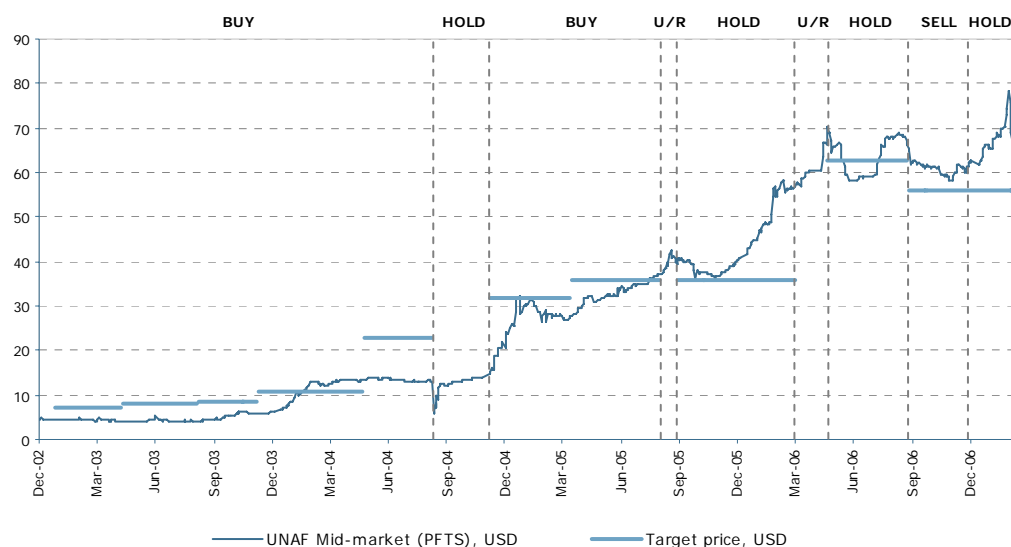
Date	12M target price, USD	Market price, USD	Recommendation	Action
20 Jan 03*	7.28	4.43	BUY	Initiate
17 Feb 03	7.36	4.32	BUY	Maintain
07 May 03	8.13	4.23	BUY	Maintain
03 Sep 03	8.34	4.05	BUY	Maintain
05 Dec 03	10.70	5.87	BUY	Maintain
19 May 04	22.65	13.23	BUY	Maintain
06 Sep 04	Pending	5.93	HOLD	Downgrade
03 Dec 04	32.00	15.17	BUY	Upgrade
11 Apr 05	35.70	27.75	BUY	Maintain
26 Aug 05	Pending	37.00	N/A	Suspend
22 Sep 05	35.70	39.20	HOLD	Downgrade
28 Mar 06**	Pending	57.28	N/A	Review
15 May 06	62.60	66.83	HOLD	Maintain
21 Sep 06	56.00	65.45	SELL	Downgrade
28 Dec 06	56.00	62.41	HOLD	Upgrade
07 Mar 07	56.00	*** 62.48	HOLD	Maintain

* This stock was covered by analysts currently engaged with Concorde Capital prior to the legal inception of the company in October 2004, recommendations are supported by research

** Until December 2005 the company was covered by Andriy Gostik, who now focuses on another sector. In January 2006, Vladimir Nesterenko took over coverage.

*** PFTS closing price as of Dec. 27, 2006

Recommendation history, USD



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