

HOLD

May 21, 2007

12M Target: USD 0.19

Market price: USD 0.23

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Bloomberg UTEL.UZ
Reuters UTEL.PFT
Xetra UK1
DR : Ord. Shares 1 : 50

Shares, mln 18,726.2

Stock data

Market price, USD 0.23
52 Wk H/L, USD 0.24/0.17

MCap, USD mln 4,307.0

Ownership

State 92.86%
Other 7.14%

Free float

Shares 2.5%
MCap, USD mln 107.7

12M target

Price, USD 0.19
Downside -17%

	Net Revenue	EBITDA	Net Income
2006	1,327	391	100
2007E	1,401	418	43
2008E	1,444	411	64

	EV/S	EV/EBITDA	P/E
2006	3.5	11.8	46.0
2007E	3.5	11.6	42.7
2008E	3.5	12.4	100.1

On May 22, the State Property Fund will sell a 1% stake of Ukrtelecom at local stock exchange:

- Starting price per share: USD 0.2277 (UAH 1.15), which is USD 42.64 mln for the whole stake, or USD 4.26 bln MCap
- The stake is broken down into 40 lots of 4.5 mln shares (lot starting price USD 1.025 mln) and one lot of 7.262 shares (lot starting price USD 1.654 mln)

Free float will increase from 2.5% currently, causing a 40% increase in share supply. We expect an increase in demand for shares due to higher stock liquidity.

Ukrtelecom's 3G roll-out program is a year old now. Test launch is expected in summer 2007. Success of mobile project is secured by state protection and possible cooperation with global mobile leader Vodafone.

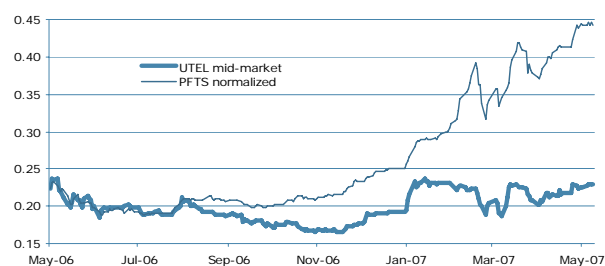
The company is beginning to run out of its own cash from operations to finance its mobile program and is starting taking on debt. Estimated need in external debt will raise Net Debt/EBITDA from 0.9 in 2006 to 2.1 by 2008. Growing financial leverage would increase vulnerability of the stock price to negative market events in the mid-term.

Ukrtelecom trades with a 25% premium to peers on EV/Sales and 80% premium on EV/EBITDA, which we relate mainly to Ukrtelecom's pre-privatization status and expectations for the company's revenue growth. A 47% discount to peers on EV/Customers indicates long-term growth potential.

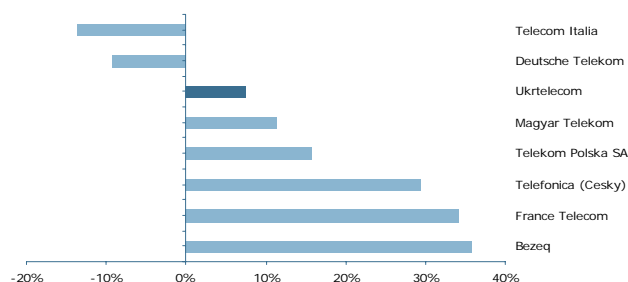
Given that control remains with the state, our DCF valuation yields a twelve month fair price of USD 0.19 per share, which implies a 17% downside to the current market price and the starting price for bids proposed by the SPF.

We downgrade our target to USD 0.19, but opportunistically re-iterate a HOLD recommendation.

Trading history, USD



Performance, 52 week

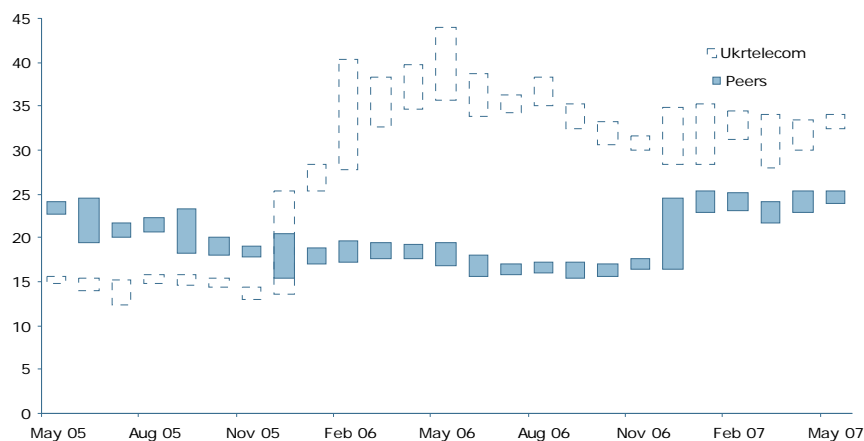


Source: PFTS, Bloomberg

Privatization expectations keep premium valuation

In the last two years privatization talk has become frequent, which has heated interest in the stock. For the last year, UTEL has traded at a premium to its peers.

P/E history: UTEL vs peers' range*



Source: Bloomberg, Concorde Capital calculations

* For the list of peers, refer to page 7

Why is the SPF privatizing Ukrtelecom?

This year parliament is relying on revenues from Ukrtelecom's privatization to fill the budget gap. The total plan for incomes from privatization for 2007 is USD 2.0 bln. Ukrtelecom is among several remaining state assets whose privatization can cover most of the plan's need, thus the SPF is moving ahead with the company's privatization.

The SPF has declared plans to privatize 5% of Ukrtelecom on local stock exchanges (split into five blocks of 1%), and place 37.86% on international stock exchange(s). In case the SPF manages to sell 42.86% of Ukrtelecom at the declared price of USD 0.23 per share, it will cover 91% of the privatization plan for this year.

Share overload or liquidity growth?

Depending on Ukrtelecom's fundamentals and news flow, the privatization of a 1% stake can cause the following:

- Significant incremental supply (USD ~40 mln new free float) might put pressure on the stock price
- Increase in liquidity can attract larger funds with higher liquidity requirements

Mobile segment exposure: Value creation or value destruction?

Impediments that Ukrtelecom might face in the realization of its mobile service program (entrance to the saturated market with two dominant players) might be surmounted by strong state support (highly likely) or a creative marketing policy (also likely in case of cooperation with global leaders).

Case study: Return on investment in the mobile segment, The experience of Astelit

Mobile operator Astelit that started operations in February 2004 used the following marketing strategy:

- undercut major players by dumping prices
- differentiate itself as an innovative operator providing a wide range of additional services

The second strategy brought success in the short-term only, as major operators started efficiently copying Astelit's new successful projects.

The first strategy negatively affected Astelit's financials. Astelit did not reach its breakeven point even after three years of operation. In 2007, a major operator decided to respond to Astelit's low tariffs, launching low-cost tariff services.

Astelit financial results

	2005	2006
Sales, USD mln	45.6	87.9
EBITDA, USD mln	-64.7	-83.8
<i>margin</i>	-142%	-95%
Net Income, USD mln	-100.4	-198
<i>margin</i>	-220%	-225%

Source: Turkcell, Euroasia

Why Ukrtelecom can do it?

There are number of reasons why we remain optimistic on Ukrtelecom's mobile services:

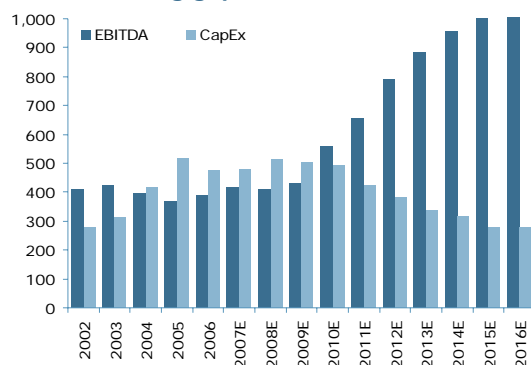
- Ukrtelecom already has a fixed-line customer base and can provide cheap calls between its fixed and mobile clients.
- The company has a chance to launch integrated fixed/mobile services to its customers.
- It has a basis for construction of its mobile network (nation-wide backbone network, service departments and real estate in every town and large village) which will allow it to spend less on CapEx compared to Astelit.
- Ukrtelecom remains in state hands, and can be granted privileges from regulators, if needed.
- Recently rumors surfaced that the world's largest mobile operator, Vodafone, showed interest in jointly developing the 3G mobile network with Ukrtelecom. In case of cooperation, this will add significant marketing resources to Ukrtelecom's project.

Main risk for shareholder value: Growing financial leverage

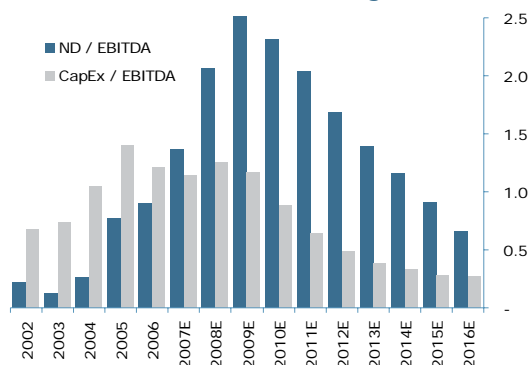
Large CapEx program to decrease shareholder value

Expansion to mobile services foresees high CapEx for network construction. Without its ability to generate enough cash from operations to finance increasing CapEx needs, a significant increase in external financing is expected.

UTEL financing gap, USD mln



UTEL financial leverage indicators

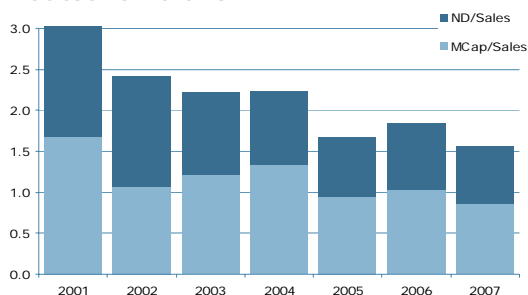


Source: company data, Concorde Capital research

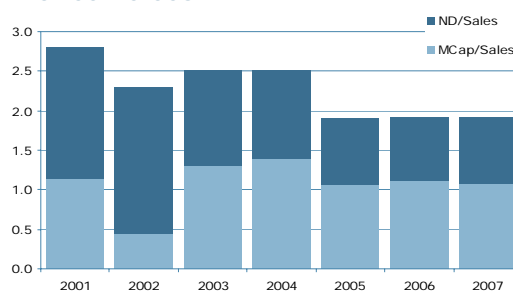
The large payback period for its mobile project implies slow growth in firm value. This, along with an increase in debt in Ukrtelecom's capital structure raises a risk of growing volatility for shareholder value.

The experience of France Telecom illustrates this risk well: while its EV/S ratio was comparable to that of Deutsche Telekom in 2001 and 2002, larger debt created greater downside pressure on shareholder value in 2002.

EV/Sales decomposition:
Deutsche Telekom



France Telecom



Source: Bloomberg, Concorde Capital calculations

Value-adding factors:

“Large privatization”

A possible source for guaranteeing stability in Ukrtelecom's shareholder value is additional financing from privatization. As it was stipulated in the law on Ukrtelecom's privatization adopted in 2000 (the law was cancelled in 2006), 30% of income from privatization should be directed to finance Ukrtelecom's investment needs. In the event a “large” privatization of Ukrtelecom takes place in the future, the state might follow the same policy. Still, there are no signals from the government about the prospects for a full privatization of Ukrtelecom.

Cooperation with Vodafone

Cooperation with Vodafone in developing Ukrtelecom's 3G mobile network would be beneficial for Ukrtelecom as the global mobile operator can add its marketing and financial resources to the project.

Valuation: DCF

All the assumptions of our operating model remain unchanged (refer to our UTEL report as of January 3, 2007)

Valuation model, UAH mln, May 18, 2007

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBITDA	2,109	2,077	2,181	2,824	3,313	3,977	4,466	4,828	5,052	5,239
EBIT	1,059	959	998	1,579	2,023	2,653	3,118	3,463	3,679	3,858
Tax Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Taxed EBIT	795	720	748	1,184.1	1,517.1	1,989.5	2,338.6	2,597.5	2,759.2	2,893.8
Plus D&A	1,050	1,118	1,183	1,245	1,290	1,324	1,347	1,365	1,373	1,381
Less CapEx	(2,362)	(2,600)	(2,548)	(2,488)	(2,140)	(1,922)	(1,708)	(1,590)	(1,400)	(1,403)
Less change in OWC	(341)	(11)	(21)	(24)	(33)	(38)	(35)	(29)	(36)	(22)
FCFF	(834)	(774)	(637)	(83)	635	1,354	1,944	2,343	2,695	2,850
WACC	14.9%	12.4%	11.2%	10.6%	10.1%	9.9%	9.7%	9.6%	9.8%	10.2%
Discounted cash flow		(720)	(533)	(63)	436	847	1,108	1,219	1,277	1,226
Sum of discounted CF		4,797								
							Perpetuity growth rate			2.0%
							WACC to perpetuity			9.0%
Terminal value		17,861								41,527
							Implied exit EBITDA multiple			7.9 x
Firm value		22,658								
Portion due to TV		79%								
Less net debt		(4,772)								
Equity value		17,887								
Implied 12M price, USD		0.19								

Sensitivity analysis

Implied Share Price, USD					
WACC Y1-10	Perpetuity Growth Rate				
	1.0%	1.5%	2.0%	2.5%	3.0%
-1.5%	0.19	0.20	0.22	0.24	0.26
-1.0%	0.18	0.19	0.21	0.23	0.24
-0.5%	0.17	0.18	0.20	0.21	0.23
+0.0%	0.16	0.18	0.19	0.20	0.22
+0.5%	0.16	0.17	0.18	0.20	0.21
+1.0%	0.15	0.16	0.17	0.19	0.20
+1.5%	0.14	0.15	0.16	0.18	0.19

Implied Share Price, USD					
WACC to perpetuity	Perpetuity Growth Rate				
	1.0%	1.5%	2.0%	2.5%	3.0%
7.5%	0.20	0.22	0.24	0.26	0.30
8.0%	0.19	0.20	0.22	0.24	0.27
8.5%	0.17	0.19	0.20	0.22	0.24
9.0%	0.16	0.18	0.19	0.20	0.22
9.5%	0.15	0.17	0.18	0.19	0.21
10.0%	0.15	0.16	0.17	0.18	0.19
10.5%	0.14	0.15	0.16	0.17	0.18

Peer valuation

Peer financials, USD mln

Net revenue				EBITDA			Net income			Customers	MCap
2006	07E	08E	2006	07E	08E	2006	07E	08E	mln		
Emerging markets											
Magyar Telekom	3,190	3,689	3,713	n/a	1,426	1,457	364	469	509	9	5,988
Telekom Polska	6,002	6,588	6,541	n/a	2,802	2,786	675	837	911	24	11,917
Telefonica O2 Czech Rep	2,715	2,998	3,061	1,141	1,353	1,362	355	453	502	8	9,544
Telekom Slovenije	934	1,011	1,067	n/a	443		130	157	168	n/a	3,730
Bezeq	2,745	2,690	2,692	708	1,007	1,025	168	249	288	n/a	4,191
Bulgarian Telecom	637	739	792	217	321	397	85	220	252	3	2,265
UTEL	1,327	1,400	1,444	391	418	411	93	100	43	10	4,264
Developed markets											
Telecom Italia	39,257	43,165	43,871	13,366	17,445	17,426	3,787	3,491	3,733	75	52,911
Telekom Austria	5,974	6,489	6,540	2,076	2,536	2,537	705	733	781	10	12,756
Deutsche Telekom	77,005	84,686	85,661	16,844	25,938	26,411	3,973	4,120	4,942	157	75,648
France Telecom	64,898	71,045	71,507	22,799	25,147	25,310	5,195	5,935	6,337	149	77,883

Source: Bloomberg, Company data, Concorde Capital

Peer comparison

Peer comparison	EV/S		EV/EBITDA		P/E		EV/Customers
	2007E	2008E	2007E	2008E	2007E	2008E	USD
Emerging markets							
Magyar Telekom	2.0	2.0	5.2	5.2	12.8	11.8	828
Telekom Polska	2.1	2.0	5.0	4.8	14.2	13.1	575
Telefonica O2 Czech Rep	3.3	3.2	7.2	7.2	21.1	19.0	1,221
Telekom Slovenije	3.9	3.7	8.9	n/a	23.8	22.2	n/a
Bezeq	2.0	2.0	5.3	5.2	16.8	14.6	n/a
Bulgarian Telecom	3.4	3.1	7.7	6.2	10.3	9.0	827
Mean	2.8	2.7	6.6	5.7	16.5	14.9	863
Developed markets							
Telecom Italia	2.4	2.3	5.8	5.7	15.2	14.2	1,378
Telekom Austria	2.6	2.5	6.6	6.4	17.4	16.3	1,719
Deutsche Telekom	1.5	1.5	4.8	4.8	18.4	15.3	875
France Telecom	1.6	1.6	4.6	4.4	13.1	12.3	873
Mean	2.0	1.9	5.5	5.3	16.0	14.5	1,211
Ukrtelecom							
	3.5	3.5	11.8	12.2	38.8	47.4	458
Premium to:							
Emerging markets	25%	29%	80%	113%	135%	217%	-47%
Developed markets	72%	78%	117%	129%	142%	226%	-62%
Implied price, USD:							
By emerging market peers	0.18	0.16	0.12	0.08	0.09	0.03	0.43
By developed market peers	0.12	0.10	0.09	0.07	0.09	0.03	0.62

Source: Bloomberg, Company data, Concorde Capital

Financials

Income Statement Summary, USD mln

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Net Revenues	1,295	1,327	1,401	1,444	1,523	1,614	1,738	1,883
Change y-o-y	N/M	2%	6%	3%	5%	6%	8%	8%
Cost Of Sales	(817)	(816)	(869)	(910)	(975)	(936)	(956)	(960)
Gross Profit	478	511	532	534	548	678	782	922
Other Operating Income/Costs, net	(29)	(38)	(21)	(22)	(22)	(22)	(22)	(22)
SG&A	(81)	(82)	(94)	(101)	(94)	(97)	(104)	(113)
EBITDA	368	391	418	411	432	559	656	787
EBITDA margin, %	28.4%	29.5%	29.8%	28.5%	28.4%	34.6%	37.7%	41.8%
Depreciation	(191)	(203)	(208)	(221)	(234)	(247)	(255)	(262)
EBIT	177	188	210	190	198	313	401	525
EBIT margin, %	13.7%	14.2%	15.0%	13.2%	13.0%	19.4%	23.0%	27.9%
Interest Expense	(30)	(55.9)	(58)	(79)	(102)	(121)	(116)	(118)
Financial income/(expense)	36	31	36	36	36	36	36	36
Other income/(expense)	(23)	(29)	(30)	(79)	(30)	(30)	(30)	(30)
PBT	160	134	157	67	101	198	290	413
Tax	(59)	(42)	(58)	(25)	(37)	(72)	(106)	(151)
Net Income	102	93	100	43	64	125	184	262
Net Margin, %	8%	7%	7%	3%	4%	8%	11%	14%
Dividend Declared	149	47	30	13	19	38	55	105

Balance Sheet Summary, USD mln

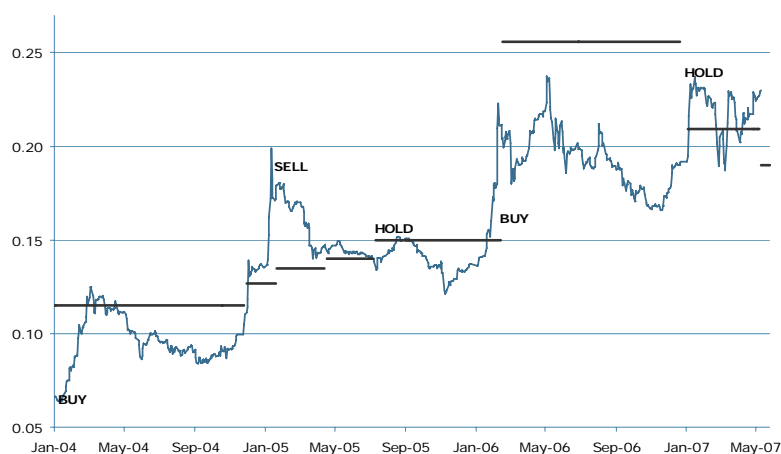
	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Current Assets	671	444	479	465	490	468	490	531
Cash & Equivalents	397	190	168	144	152	110	104	113
Trade Receivables	144	151	154	159	168	178	191	207
Inventories	73	65	98	101	107	113	122	132
Other current assets	57	38	59	61	64	68	73	79
Fixed Assets	1,756	1,857	2,143	2,450	2,740	3,019	3,184	3,322
PP&E, net	1,497	1,673	1,906	2,182	2,452	2,725	2,913	3,063
Other Fixed Assets	259	184	237	268	289	293	272	259
Total Assets	2,427	2,301	2,622	2,915	3,231	3,487	3,675	3,852
Shareholders' Equity	1,409	1,548	1,631	1,661	1,705	1,793	1,922	2,079
Share Capital	903	903	903	903	903	903	903	903
Reserves and Other	516	562	574	574	574	574	574	574
Retained Earnings	(10)	83	153	183	228	316	444	602
Current Liabilities	335	204	292	300	328	349	430	469
ST Interest Bearing Debt	10	2	54	55	69	75	135	149
Trade Payables	93	46	98	101	107	113	122	132
Accrued Wages	18	15	14	14	15	16	17	19
Accrued Taxes	7	26	14	14	15	16	17	19
Other Current Liabilities	356	161	112	116	122	129	139	151
LT Liabilities	684	549	699	954	1,197	1,344	1,322	1,304
LT Interest Bearing Debt	671	540	685	940	1,183	1,330	1,308	1,290
Other LT	12	9	14	14	14	14	14	14
Total Liabilities & Equity	2,427	2,301	2,622	2,915	3,231	3,487	3,675	3,852

Source: Company data, Concorde Capital

Analyst Certification

I, Alexander Paraschiy, 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.

Price and target History, USD



Source: PFTS, Concorde Capital

Date	Closing price, USD	Target price, USD
21-May-07	0.230	0.190
3-Jan-07	0.190	0.209
23-Feb-06	0.211	0.256
18-Jul-05	0.136	0.150
25-Apr-05	0.145	0.140
27-Jan-05	0.179	0.135
6-Dec-04	0.111	0.127

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

23-Dec-03	0.062	0.115
8-Jan-03	0.049	0.085

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