Ukraine:
Telecommunications

Company Update

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CONCORDE CAPITAL

Ukrtelecom

The Time Has Come

Ukrtelecom: BUY

Bloomberg Ticker: UTEL UZ
Market Price: USD 0.210
Target Price: USD 0.256
Upside: 22%
Current MCap USD 3.93 bln

February 23, 2006

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SUMMARY

Ukrtelecom is **about to undergo radical changes** which are going to alter the attitude of consumers, regulators and potential investors to the company.

Mobile Market Entry

UTEL is entering the profitable and rapidly growing mobile market, where it will have several competitive advantages including its fixed line infrastructure, high-capacity main networks, monopolistic access to the last mile, and the opportunity to be a pioneer in providing high-quality innovative telecommunication services by taking advantage of being the first and only (so far) company to obtain a G3 license.

UTEL has set ambitious goals as part of its entrance into the mobile market, and even if it only accomplishes half of them it will significantly increase its capitalization in the midterm. Note however, the effect from entering the mobile market entry will only be noticeable in three to four years, making the company a bit of a long term investment.

Stagnation in the fixed line segment, caused by mobile cannibalization has dealt a blow to UTEL's voice revenues. However, we expect UTEL to compensate for this by developing its data segment and participating in the growth of the mobile sector.

Privatization

The fact that the company is being prepared for privatization implies a positive shift in the attitudes of the state regulatory bodies which the company depends on. In addition to the mobile license, we expect tariff policy changes to be beneficial for the company during the preparation process. At the very least, the new tariffs adopted by the NCRC in September are expected to take effect before the company's privatization.

Privatization and the entrance of a new strategic investor in mid 2006 would improve the company's structure and inject new blood into the company's Soviet era marketing department. To succeed UTEL needs to support its developed infrastructure with an innovative marketing strategy - two things the company is aiming to put into place.

Valuation

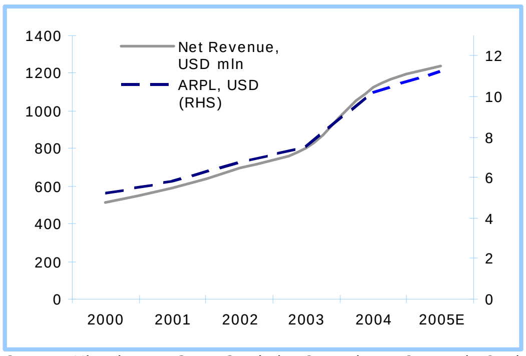
To capture the coming change in the company's business profile, in our valuation, we place more stress on our DCF model. The model is based on the assumption of revenue growth with CAGR 12% and EBITDA growth with CAGR 15.5% during the next five years, due mainly to the company's exposure to more rapidly growing and profitable segments. We change our 12M target to USD 0.23 and upgrade our recommendation to **BUY**.

REVENUE UP, PROFITS DOWN

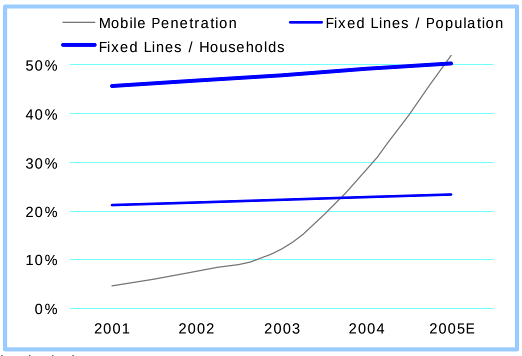
Revenues:

Revenues for UTEL grew by 21% in 2004, and are expected to grow 10% in 2005.

UTEL Proceeds



Ukraine Penetration Data



Source: Ukrtelecom, State Statistics Committee, Concorde Capital calculations

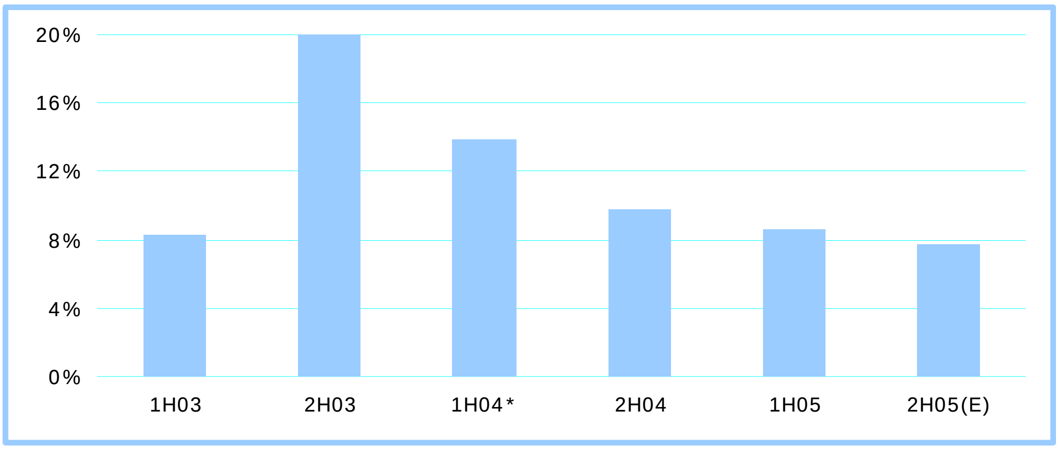
The key driver for 2004 and 2005 sales was LD fixed-to-mobile (FTM) traffic. Revenue from FTM traffic almost tripled in 2004, due to the fact that tariffs increased by 3.5 times in September 2003, and due to the growth of mobile penetration. Other LD traffic declined by about 12% in 2004, and by about 5% in 2005, due to mobile cannibalization. However, total LD (including FTM) revenue increased by 30% yoy in 2004 and by about 10% in 2005. Local traffic and revenues increased by only 2% yoy in 2004 and 2005.

The key drivers behind UTEL's 2005 revenues remained FTM, MTF, and the internet/data segments.

Profitability:

FTM traffic growth and LD traffic decline led to a drop in the company's profitability in 2004-2005. As 60% of UTEL's revenue from FTM is transferred directly to mobile operators (i.e. are expenses for UTEL), only 40% of the FTM tariff is available to UTEL. Further, after subtracting costs related to FTM traffic, UTEL only receives about 10% of the profit from an FTM call. Thus, the increase in FTM revenue with current distribution pattern of FTM proceeds hurt Ukrtelecom's profitability.

Net Margin Of Ukrtelecom (UAS)

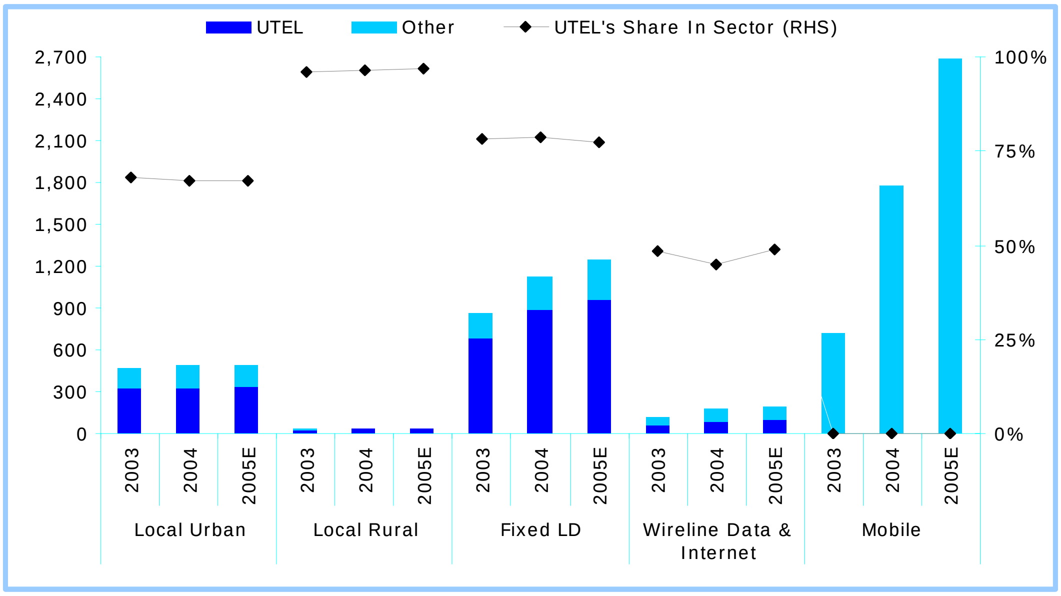


Source: Ukrtelecom, Concorde Capital estimates
** Re-adjusted by UTEL dividend payments (one-time event), reduced by 8.2% compared to reported*

Market Position Under Siege

While UTEL has saved its market share in all the telecommunication segments where it is present, the company has lost its overall share in the telecommunication market. This is mainly due to the three-digit growth rate of the mobile sector, where UTEL is currently not present. After receiving its UMTS mobile license in December 2005, UTEL will be able to develop its own mobile operator in late 2006, taking advantage of growing demand for wireless telecommunication services. Even though the company missed the boat as far as entering the segment in its early stage, it can still catch up to major mobile operators by offering innovative services.

Revenues By Segment (USD mln): Ukraine And UTEL



Source: State Statistics Committee, Ukrtelecom, Concorde Capital calculations

In its development UTEL is currently limited by two main factors, which we believe will be eliminated after the company's privatization:

- Strict regulations on the fixed telecom market, which are exasperated by the company's universal service obligations, prevent the company from being flexible with its tariffs – an important tool for competing with mobile operators for voice traffic.
- The technical mindset of UTEL's management, and its lack of a "customer first" attitude. This mindset has led to UTEL's infrastructural dominance but has prevented it from being competitive with alternative fixed operators in the fight for high-quality customers.

The company's "pre-privatization" status and aggressive plans make us optimistic the first deterrent will be eliminated and increase the attractiveness of the company before its privatization. While it looks likely the second deterrent will be eliminated after the company is privatized, with the arrival of a large market savvy strategic investor.

Local Fixed Segment: A Thankless Task - For Now

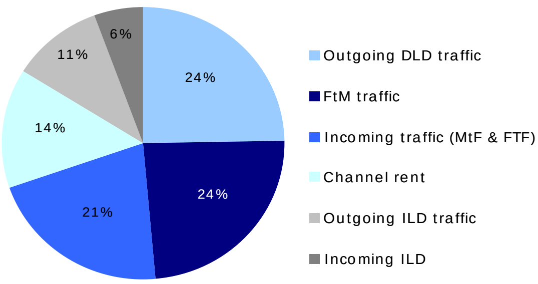
Sluggish growth in local telephony is in line with the growth of fixed subscribers. Increasing competition caused a slight decrease in UTEL's share of the urban residential and business communications sub-segment, while the company's almost 100% share in the rural residential sub-segment remained untouched. The latter comes as no surprise, as rural calls are priced below costs and no one competes with UTEL in this segment due to the universal service obligations that come with it.

In 2005 revenue in the local segment is estimated to have grown by 1-2%. The expected change in tariffs for local calls in 2006 will boost UTEL's local call revenue by about 30% this year (refer to page 16 for more details).

Long Distance And Related Revenues

Ukrtelecom and its subsidiary Utel account for 78% of the fixed LD market. LD revenues account for 2/3 of UTEL's total revenue. Most LD revenues come from outgoing LD traffic, FTM traffic, terminating traffic from alternative fixed and mobile subscribers, and from the leasing of backbone and international channels.

LD Revenue Distribution, 2004*: Ukrtelecom w/o Utel

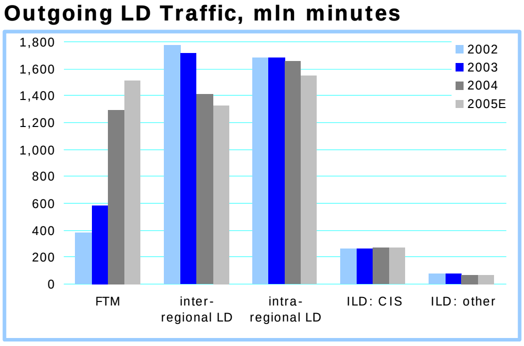


Source: Ukrtelecom
** No company data for 2005 is currently available*

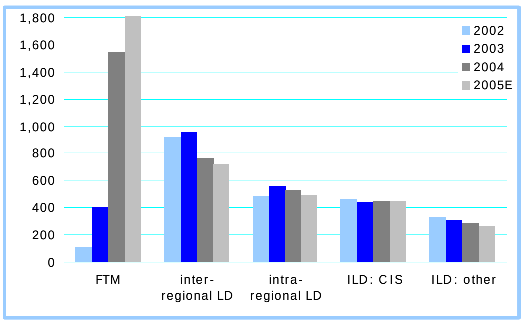
Outgoing LD: A Shrinking Segment

This segment has started to feel pressure from increased mobile competition. The only revenue driving factor here is the increase of FTM revenues caused by the double digit growth of FTM traffic and the triple-digit growth of FTM tariffs in 2004 compared to mid 2003.

Outgoing LD Traffic, mln minutes



LD Revenues, UAH mln



Source: Ukrtelecom, Concorde Capital estimates

We estimate that outgoing LD revenues have increased by about 4% in 2005: while DLD and ILD revenues fell due to mobile cannibalization, and FTM revenues rose.

Incoming LD: Bread & Butter

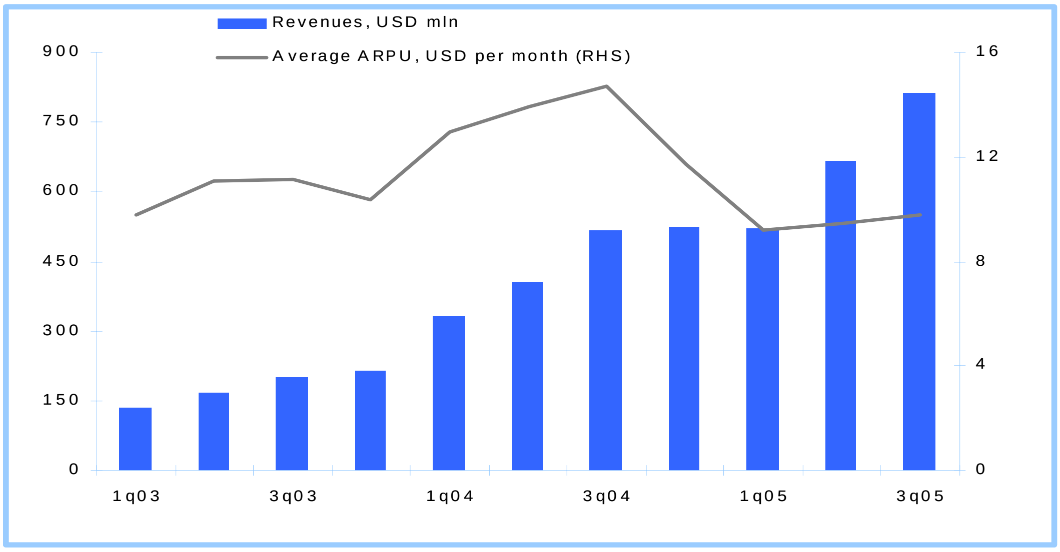
The company earned about 11% of its revenue on the termination of incoming traffic. UTEL's monopoly on access to the fixed last mile means this revenue source will continue to grow in the future. One of the key growth driving factors for incoming traffic revenues is the growth of MTF calls in connection with expanding mobile penetration. We estimate revenue from this segment to have grown by about 25% in 2005, and expect about the same rate in 2006.

Mobile Cannibalization: Taking A Toll

Ukraine's mobile segment grew by leaps and bounds in 2004-2005. Mobile penetration has increased over the past year at a much higher rate than we expected - the growth of disposable incomes due to social payments and clever promotions have fueled this expansion.

A 'war' between the country's two main operators for subscribers led to boom in mobile penetration in late 2004-2005, which significantly reduced their ARPU. Mobile ARPU in 1H05 decreased to USD 9.31 - the first time in Ukraine that mobile ARPU dropped lower than fixed ARPU (USD 11).

The Ukrainian Mobile Market



Source: State Statistics Committee, Ukrtelecom, Concorde Capital estimates

In the DLD segment, users have nearly equal access to both fixed and mobile telecommunication services, making price a key factor in the competition between operators. The fixed segment's capped tariffs (tariffs have not changed since June 2002) prevent UTEL from really being able to compete in this segment: mobile operators are flexible in their tariff policy which makes it possible for them to provide more attractive international LD services to their customers.

Case Study: UTEL's Tariff Rigidity

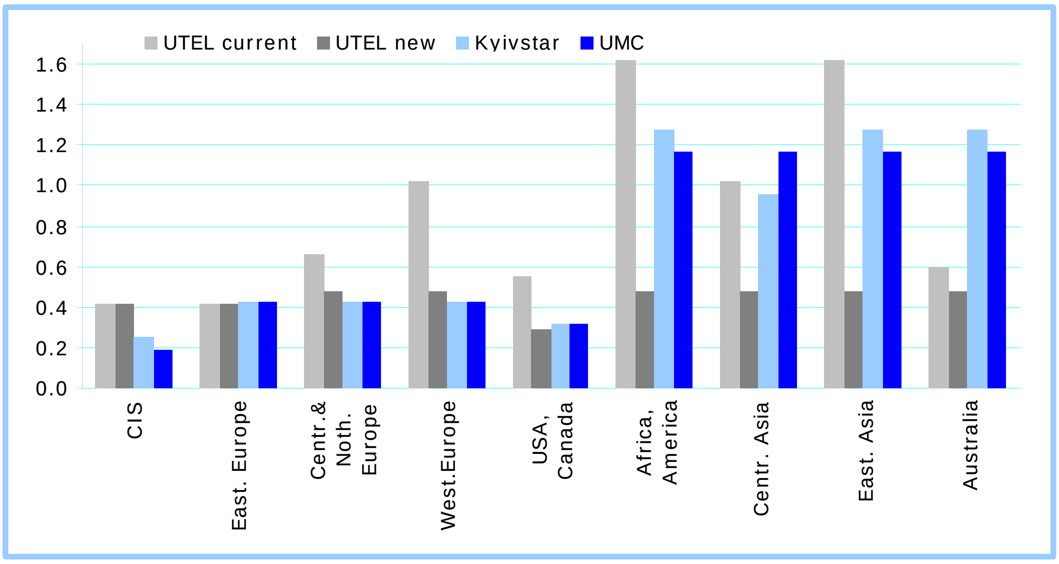
UTEL has been pushing for a rebalance of fixed telecom tariffs since mid 2004, however, the changing of the telecom sector regulator which started in August 2004 (when the Ministry of Communications was subordinated to the Ministry of Transport) and finished in May 2005 (when the National Communication Regulation Committee (NCRC) started work), shelved all tariff changes.

After the NCRC approved new tariffs in August 2005 (increased local fixed telecom tariffs and reduced ILD rates), the tariff changes then had to be confirmed by the Association of Trade Unions (ATU). However, because the NCRC's decree foresees increases of "social" local tariffs, the Association refused to approve the changes, even though it admitted that it was clear that tariffs had to be raised for UTEL to remain profitable. However, the ATU claimed that as it is its job to protect the interests of Ukrainian citizens, it could never, by definition, agree to any tariff increases. The ATU said it would only agree to approve the tariff changes if the state pays off all the salary arrears in Ukraine's budget sector. Thus, UTEL is currently being held hostage by the ATU.

Despite the grim situation, we believe UTEL, armed with the state's backing will be able to find a compromise and usher in new tariffs in 1H06.

Ukraine's major mobile operators, UMC and Kyivstar have ILD tariffs which are lower than fixed line ILD prices for all regions except for Eastern Europe and the Middle East. Currently roughly 13 mln Kyivstar customers and 13 mln UMC customers take advantage of this low cost option, causing an outflow of ILD revenues from UTEL to mobile operators.

Minimum ILD Tariffs, USD Per Minute



Source: company data, NCRC, Concorde Capital calculations
Note UTEL's minimum tariffs take affect on weekends; minimum tariffs for Kyivstar and UMC are tariffs for their special VoIP service; UTEL's new tariffs have been adopted by the NCRC, but have not been put into a effect due to legal restrictions

Note that the new (not yet implemented) ILD tariffs for UTEL will be lower than the current tariffs for mobile operators. However, we expect mobile operators to adjust their ILD tariffs downward after the new fixed tariffs become active, so UTEL's advantage from the rebalance will be minimal at best.

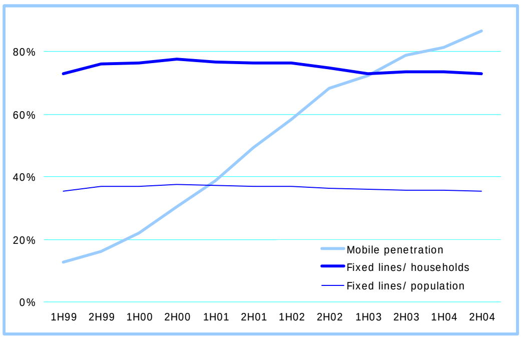
There is no information available about mobile ILD traffic in Ukraine, however, the declining rate of fixed ILD traffic during 2004 and 2005 suggests that mobile operators have absorbed part of UTEL's ILD traffic. In estimating the future of fixed and mobile ILD, we use the Hungarian and French telecom markets as a reference point, as they both went through similar situations in their ILD markets.

LD Cannibalization: An International Experience

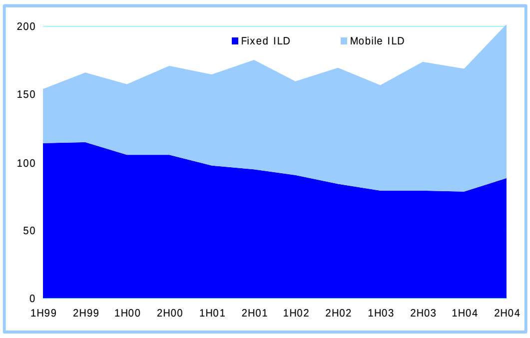
Effect On Traffic: Hungary

The Hungarian telecommunication market experience can be used to shed light on the future of fixed/mobile revenue re-distribution in Ukraine. In late 1999 the main mobile operators Pannon GSM and Vodafone started providing ILD services via VoIP at tariffs lower than the fixed operator MATAV, similar to what is happening in Ukraine. This allowed mobile operators to increase their ILD traffic 2.25 times over the last six years, which is still much lower than the growth of their mobile subscriber base (6.8x). Outgoing fixed ILD traffic dipped by about 27% in 1999-2002, but stabilized in 2004, due to the liberalization of pricing in the fixed telephony market, which allowed the fixed operator (Magyar Telecom) more flexibility in setting tariffs.

Fixed And Mobile Penetration, Hungary



International LD Traffic, '000 minutes

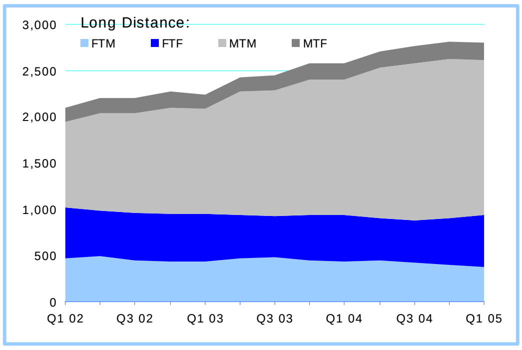


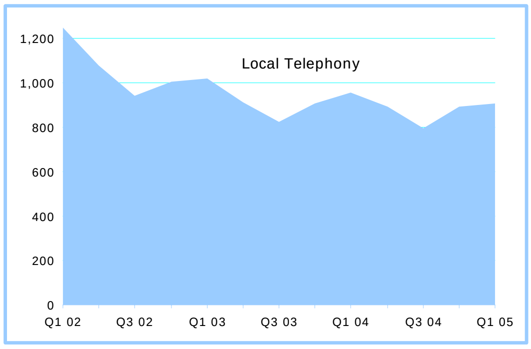
Source: The Hungarian National Communications Authority, Concorde Capital calculations

As for the Hungarian DLD market, since 2002 only the mobile segment has seen traffic growth (CAGR 9.1%), while the fixed telecom segment has stabilized at about 1 bln minutes.

What is important about mobile cannibalization is that the growth of mobile traffic coincided with a drop in local rather than long-distance traffic.

Hungarian Traffic, mln min





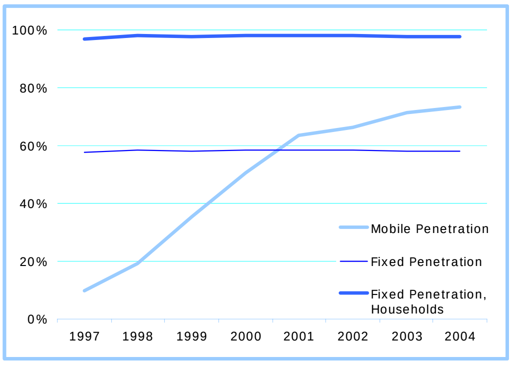
Source: The Hungarian National Communications Authority, Concorde Capital estimates

However, we do not believe this will happen in Ukraine - local tariffs are much lower than in western countries, therefore mobile communication cannot yet serve as an alternative to local calls.

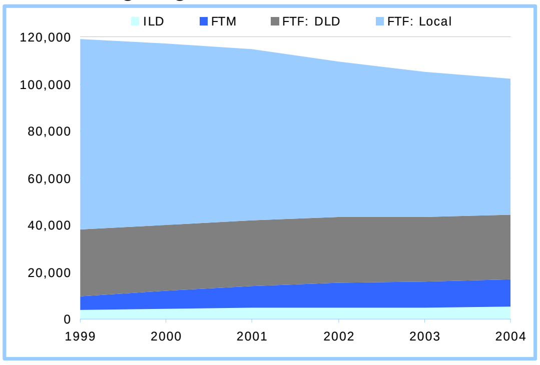
Effect On Revenues: France

In France, mobile penetration growth had no impact on fixed LD traffic.

Fixed And Mobile Penetration, France



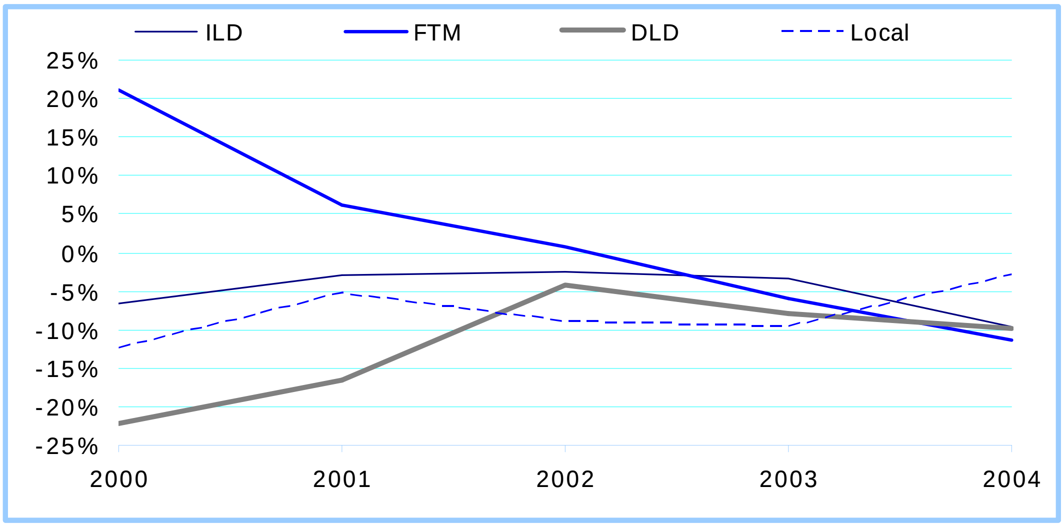
Fixed Outgoing Traffic, mln minutes



Source: The French Telecommunications Regulatory Authority, Concorde Capital estimates

However, this was only because fixed operators significantly reduced their tariffs as soon as they felt competitive pressure from mobile operators. As a result, fixed traffic remained unchanged, but revenues decreased significantly:

Fixed Revenue Change yoy



Source: The French Telecommunications Regulatory Authority, Concorde Capital estimates

What Does This Mean For Ukraine?

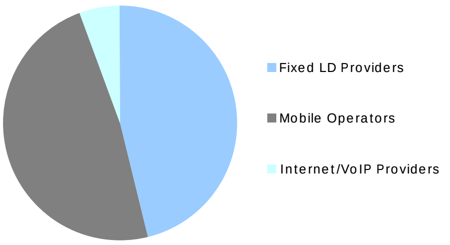
In Ukraine, where local telephony tariffs are currently much lower than mobile tariffs, we do not expect mobile penetration growth to have a significant impact on the local call segment in the near future, but we do expect the growth of local traffic to tail off in the long term.

In the fixed LD segment we expect mobile cannibalization to lead to a decrease in revenues. However, should tariffs be liberalized we believe traffic could remain at its current level.

Main Network Leasing Revenues

The booming mobile segment had a positive impact on revenues from the leasing of main networks and international gates in 2004. Revenues from Ukretelecom's main line department grew 26% in 2004, and amounted 8.7% of Ukrtelecom's revenues. The main leasers of UTEL's network are Utel, UMC and Kyivstar. Revenues from mobile operator leases grew 52% (according to our estimations) in 2004 and amounted USD 40 mln. Ukrtelecom accounted for about 80% of internet/VoIP traffic transmission in 2004-2005.

Parent UTEL: Revenue Distribution By Leaser, 2004



Source: Telecom magazine
** No data for 2005 available, but we do not expect significant changes from 2004*

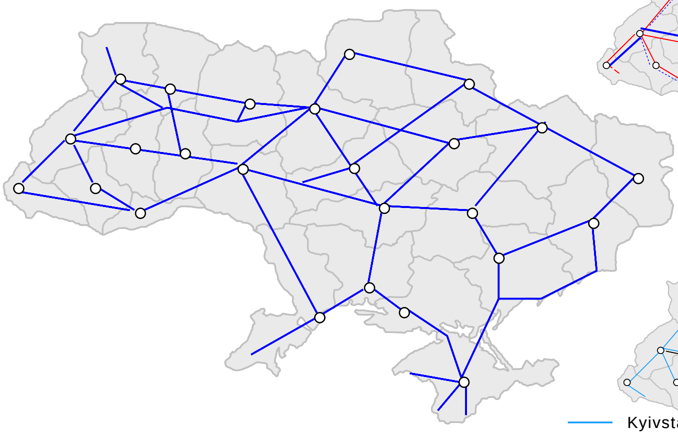
In 2006, we expect competition to become more aggressive in the transmission network sector, as the number of alternative networks is growing - by mid 2006 at least 3 nation-wide alternative networks are expected to be operational.

In 2006 some of UMC and Kyivstar's mobile traffic is expected to be switched to their own networks (currently under construction). Moreover, these mobile operators possess ILD licenses, UTEL stopped benefiting from mobile ILD growth in 2005.

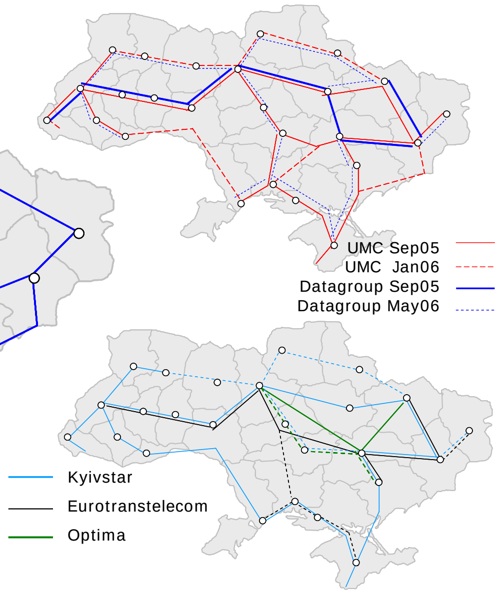
In addition to major mobile operators, other alternative operators are developing their own fixed networks:

- **Datagroup** is constructing a nation-wide DWDM network, which is expected to match UTEL's network by 2Q06. Once this happens, the company, which possess all the needed licenses, will become UTEL's most powerful competitor in data transmission and channel rent.
- **Eurotranstelecom** (ETT), controlled by Ukrazaliznitsa and Russian Railways, has its own backbone and can potentially provide data transmission services. The company plans to finish constructing its own nation-wide network in 2007. Currently, the company has no telecommunications service licenses, but may obtain them in the near future.
- **Optima Telecom**, one of Ukraine's major alternative fixed telecom providers**,** is currently in the process of being acquired by the **SCM** business group. Optima has a DWDM network connecting the three largest Ukrainian cities. In addition, **Farlep** telecom, which was acquired by SCM has local networks in Ukraine's eastern regions, along with international gates. The companies plan to expand to other cities located in central Ukraine.

UTEL Nation-Wide Main Network



Alternative Networks:



Source: company data, Telecom magazine, Concorde Capital

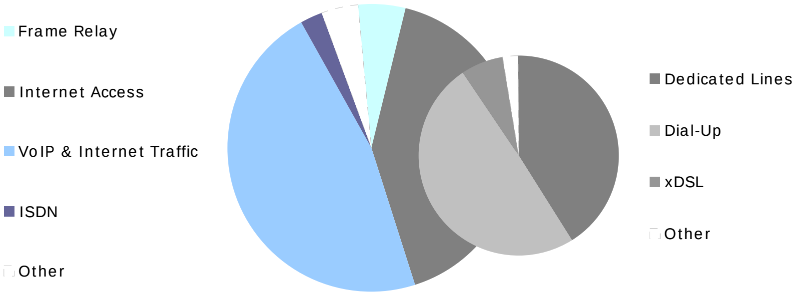
Despite the growing number of alternative networks, UTEL is unlikely to give up its position in leasing and data transmission revenues. As it has monopolistic access to the last mile in all regions - UTEL remains the only Ukrainian operator which can provide data transmission services to/from any location in Ukraine. In addition, UTEL's DWDM network will serve as the foundation for the company's expansion into the mobile market.

Moreover, UTEL serves a bridge connecting calls between different mobile operators.

Internet And Data

Data transmission is currently, and will remain UTEL's fastest growing sector (+34% growth yoy in 2004, +25% 2005(E)), however, this is the smallest sphere of the company's operations, occupying 6% of UTEL's total revenues.

UTEL Internet And Data Revenues, 2004*



Source: Ukrtelecom
** No data for 2005 available, but we do not expect significant changes in 2005 compared to 2004*

Here, UTEL's main competitive advantage is the company's monopolistic access to the national main line, the last mile, and its freedom to set tariffs for last mile consumers and alternative internet providers.

UTEL's revenues from providing internet services increased 80% yoy in 2004. It successfully implemented a post-paid internet service, which lead to a 66% jump in dial-up internet revenue for the company in 2004.

Despite its ownership of the main line, substantial investments in technical development, and the successful launch of its dial-up internet service, UTEL's marketing strategy failed to bring in customers and thus the company lost 3.7% of the internet and data market in 2004. UTEL's main rivals in the data/internet segment are the alternative fixed operators: Golden Telecom, Optima Telecom, Farlep, and small internet service providers.

In spite of its 2004 marketing failure, the company still accounted for 44.7% of the internet access and data transfer market, and remains a key player in the segment.

Public Services And Other Activities

Public services refer to payphones, telegraph and telex, cable radio and TV services.

Payphones

Ukraine's network of universal payphones has more than doubled over the last five years, and revenues from payphones have increased six times, to USD 21.1 mln.

Telegraph, Radio And TV

This segment accounts for less than 2% of UTEL's revenue. The market for telegraph and radio broadcast services is drying up, while providing TV service could potentially have a future. In particular, UTEL has the resources to transmit TV signals using its channels.

By obtaining a license for the transmission TV signals, UTEL could potentially start providing IP TV services, and become a powerful rival to local providers of cable television. However, this project cannot be implemented overnight.

FIXED REVENUES FORECAST

New Revenue Driving Segments:

- Own mobile telephony (to be launched in 2H06)
- Fixed local telephony (once the new tariffs adopted by the NCRC take effect)
- Data transfer services (which have been growing 20-25% p.a.)

Tariff Changes And Revenues

At UTEL's request, the NCRC has come up with new tariffs for fixed telephony, which, are designed to increase UTEL's revenues and competitiveness on the Ukrainian telecom market.

The Changes:

- 50% growth of flat monthly subscription charges for telephones in urban areas (30% in rural)
- 28%-30% growth of local residential calls; and doubling the cost of payphone calls
- 11%-25% growth of intra-regional call tariffs
- 12% growth of lower bound and a 17% fall in the upper bound for inter-regional LD calls
- 100-150% growth of charges for local fixed operators from the termination mobile-to-fixed calls
- 29%-70% decrease in ILD tariffs to all directions except CIS and CEE

Remember that the tariff changes have already been adopted by the NCRC, but currently cannot be introduced due to legal impediments (refer to the case on page 8). However, we expect these changes will come into effect by the start of UTEL's privatization campaign in mid-2006.

Below we take a look at the effect the tariff changes will have on the revenues for all of UTEL's segments.

Local Fixed Telephony

According to our estimates, 73% of all local telephony revenues are proceeds from flat monthly subscription charges. Once the new tariffs are approved, they will be the main driving force behind UTEL's revenue growth.

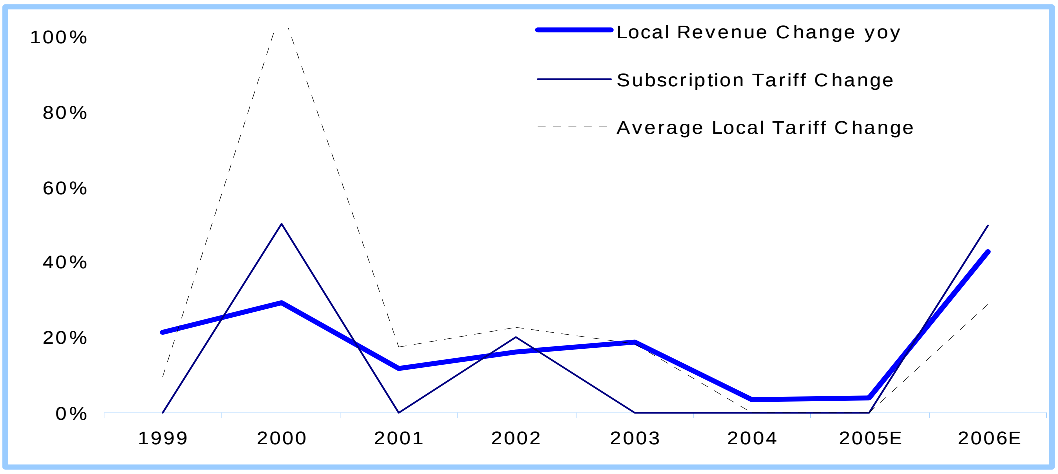
Subscription Charges

The growth of flat monthly payments for telephones will directly impact UTEL's revenue, as demand for telephones is deterred by tariff growth: the growth of fixed payments for households is less than 1% of the minimum pension in Ukraine. Thus, we expect additional annual revenue from subscription charges to be USD 113 mln (+48% compared the current tariff structure).

Traffic Revenues

In the monthly subscription charge 175 free minutes of local calls are included. In most cases, households do not exceed this limit, so most of the traffic which is charged in excess of the flat rate is generated by businesses. As these consumers are rather insensitive to local tariff changes, we expect the growth of local revenue to be close to growth in the tariffs for non-residential consumers, or about 36%.

Sensitivity Of Local Telephony Revenues To Tariffs



Source: State Committee of Telecommunications, State Statistics Committee, Concorde Capital calculations

Thus, the total growth in local telephony revenues associated with tariff growth (in 2006) is likely to be about 40%.

Another factor which will add about 2% to local telephony revenue growth is the increasing popularity of dial-up internet.

Fixed LD Revenues

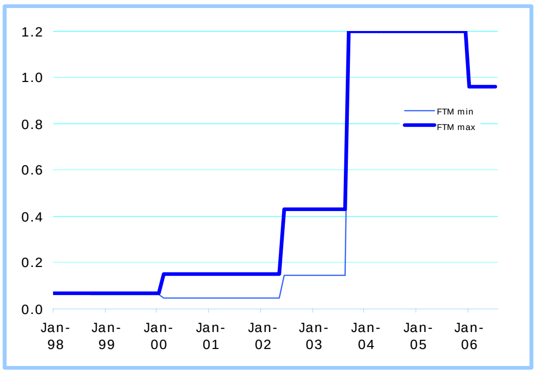
Revenues From Traffic Termination

For MTF calls, fixed line companies charge two tariffs: one for access to the local line of the MTF call addressee, and if MTF call is transmitted by the fixed line to other region, an additional fee is charged for inter-region transmission. According to the NCRC's new draft act, charges for mobile operators to access local lines will be raised by 2-2.5x. This means UTEL may earn about double what it does now for the termination of MTF calls. With MTF traffic set to grow even more over the next few years, UTEL's revenue from MTF traffic termination may more than double in 2006.

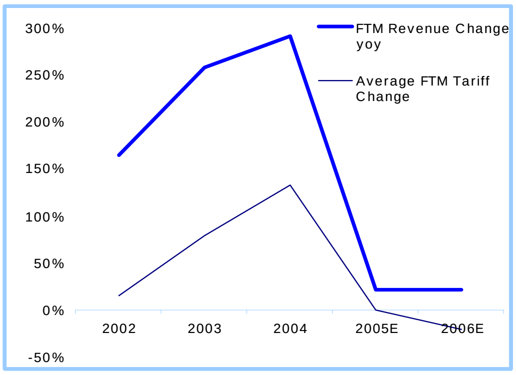
Fixed-To-Mobile Traffic

Revenue from FTM traffic has been growing in line with mobile penetration, while revenue increased the most over the last two years, mainly due to the tripling of FTM tariffs in September 2003. In 2005 the growth rate was much slower (about 20%), as users prefer to make calls to mobile phones using mobiles.

FTM Tariff History, UAH / min



FTM Tariff And Revenue Change



Source: NCRC, Ukrtelecom, Concorde Capital estimates

According to the NCRC, FTM tariffs are expected to decrease in 2006 by 20%, which is likely to make FTM calls more attractive. Thus, we expect revenue growth from FTM calls in 2006 to be near 2005 levels, despite the slowdown in mobile penetration.

As in addition to the tariff decrease, the NCRC is going to regulate the pattern of FTM revenue distribution, UTEL's margins from FTM calls will increase by about 10%. Currently, UTEL transfers 60% of its FTM revenue (UAH 0.6) to mobile operators, leaving it with only UAH 0.4. The NCRC has suggest equally the distribution pattern (50/50).

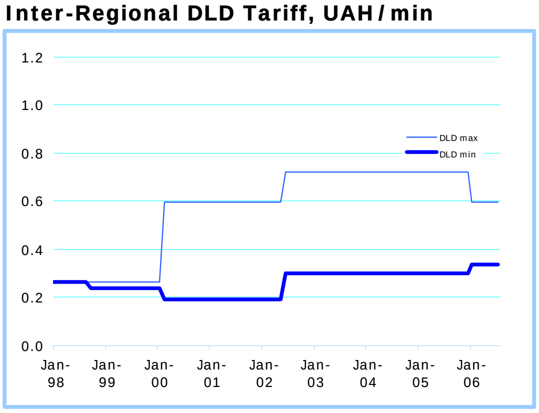
Fixed-To-Fixed DLD

Mobile cannibalization is expected to hurt this segment in the next year or two, as currently there is little difference between tariffs for LD calls initiated by mobile and fixed line subscribers. Moreover, because mobile providers offer special cheap MTM tariffs between certain groups of mobile subscribers (family tariffs, corporate tariffs), some groups of consumers prefer mobile calls to fixed LD calls.

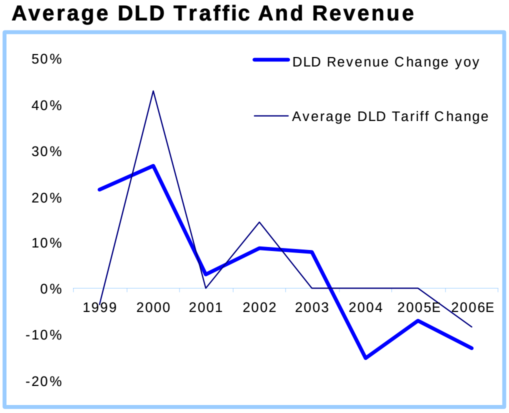
Thus, even with the expected decrease of DLD tariffs by 8%, we do not expect any growth in UTEL's DLD traffic, and a bigger drop in DLD revenues.

We estimate about 7% decrease in DLD revenues in 2005 and about a 13% decrease in 2006.

Inter-Regional DLD Tariff, UAH / min



Average DLD Traffic And Revenue

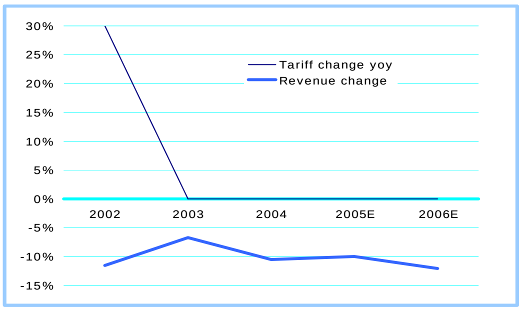


Source: NCRC, Ukrtelecom, Concorde Capital Estimates

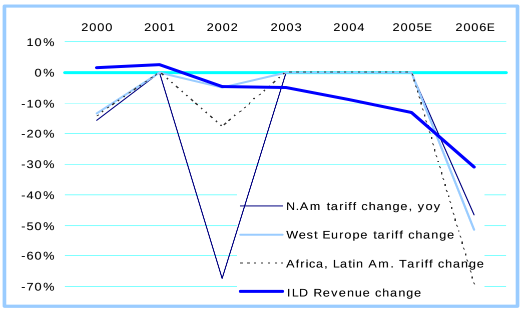
International Telephony Revenues

In these segments we do not expect an increase in revenues despite the fact that most of the tariffs will be reduced noticeably: this is because of mobile cannibalization (unlike UTEL, mobile operators are independent in their tariff policy, and can always lower their ILD tariffs to stay competitive). After examining the Hungarian experience and knowing that ILD revenues are not elastic to tariff change, we expect UTEL's ILD revenues to decline significantly after the tariff rebalance in 2006.

CIS Calls Market



Other ILD Calls

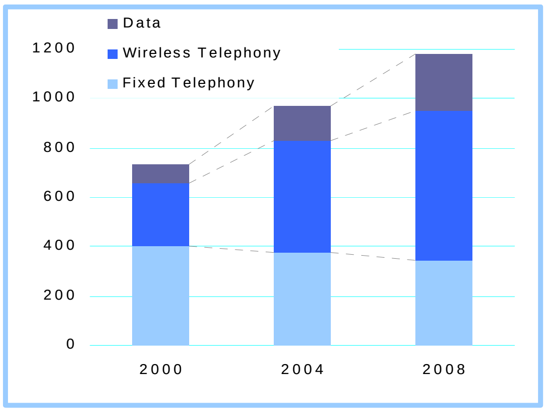


Source: Ukrtelecom, NCRC, Concorde Capital estimates

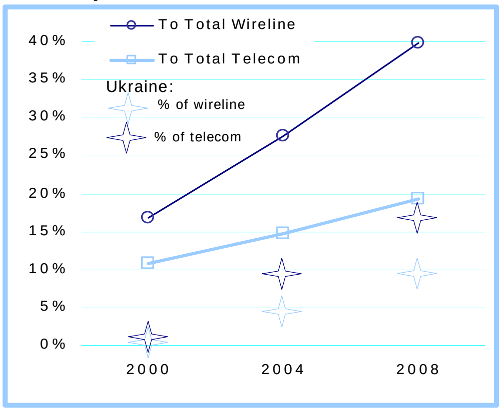
Data & Internet Access

With relatively low PC and internet penetration, the data and internet market in Ukraine occupies only about 4.9% of the total telecom market, three times less on average than in EU countries.

EU Telecom Revenues, EUR bln



EU: Proportion Of Data Revenues



Source: Deutsche Telecom, State Statistics Committee, Concorde Capital estimates

This enormous amount of internet/data growth potential makes Ukraine an attractive location for potential entrants. Ukrtelecom, as a major fixed line operator and owner of developed infrastructure, has a golden opportunity to drastically expand in this sphere.

The easiest way for UTEL to expand its presence in the data service market would be by starting a nation-wide VoIP program providing LD services. Even though most other fixed line operators already use IP technology, UTEL would still have a substancial advantage thanks to its larger customer base.

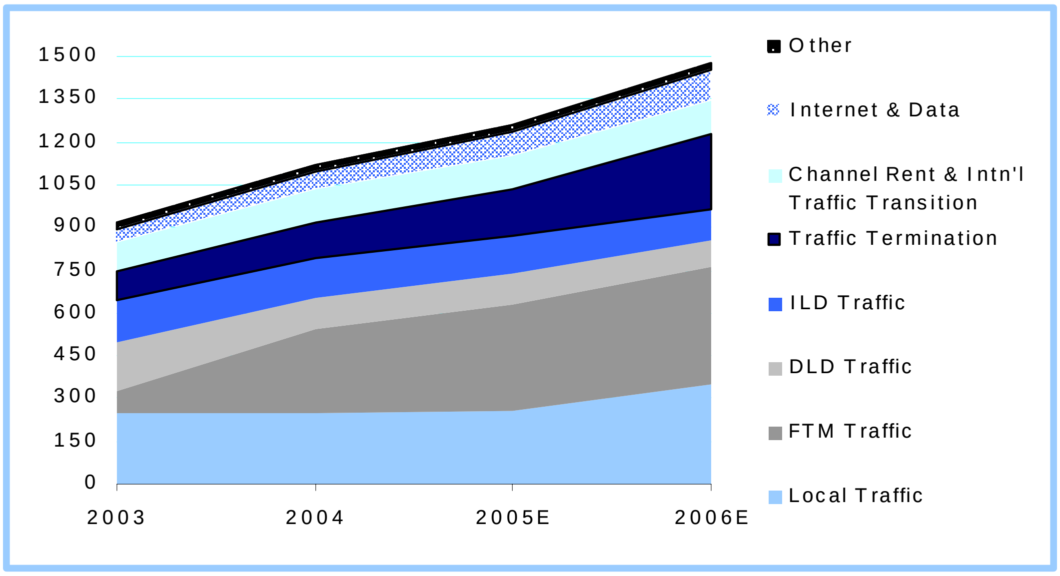
The implementation of VoIP services would significantly cut UTEL's LD service costs (VoIP is much less costly than voice telephony), which in turn would increase the company's margins (tariffs for VoIP are not allowed to be lower than 80% of voice telephony rates).

By implementing a nation-wide IP alternative to voice LD, UTEL would likely decrease its LD voice traffic significantly, this, however, could be compensated by the increase of LD VoIP traffic, meaning that revenues from fixed services would not be affected much.

Summary: Fixed Revenues Forecast

UTEL's key income drivers will be outgoing and the termination of local traffic and FTM traffic revenues. The internet and data segment should grow by about 10%, partially compensating the 10% drop in ILD traffic revenues.

UTEL Revenue Forecast USD mln



Source: Ukrtelecom, Concorde Capital estimates

UTEL's BIG GAMBLE

As all the frequencies subject to GSM standards are occupied by Ukraine's existing mobile operators, the only way for Ukrtelecom to enter the mobile segment was by launching mobile services of a new standard. The company was granted a G3 UMTS license in December 2005.

The government's move to grant UTEL a G3 mobile license may open a new page in the company's history. UTEL is the only company in Ukraine to receive the license without a tender. The government plans to hold a tender for the sale of three more licenses, however, for now UTEL is the only G3 license holder.

How Much Did It Cost?

Ukraine's current legislation does not set separate costs for UMTS licenses. Thus, UMTS license pricing follows the standards set for pricing mobile licenses and frequency use permissions. UTEL has to pay USD 68.2 mln for its five-year mobile license with a frequency range of 2,000 MHz in 2006 and USD 38.2 mln annually for the next four years – not even close to the prices mobile providers paid in Germany, Great Britain and France (more than USD 6 bln for a single license). These low entry costs, are expected to help UTEL avoid the problems Western providers faced in developing their 3G mobile networks.

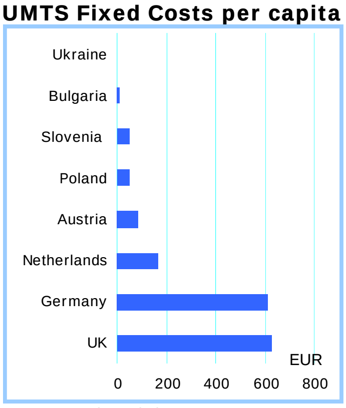
UMTS License Costs

License	Unit Type	Cost USD mln /Unit	Units	Total cost USD mln
Mobile License	Unit	1.8	X 1	= 1.8
Frequency Fixed Payment	MHz	0.8	X 35	= 28.2
Total Staring Payment				**30.0**
Annual Freq. Payment:	MHz	1.1	X 35	= **38.2**

5Y payments, USD mln	1Y	2Y-5Y	Total 5Y
	30.0+38.2	38.2	**220.8**

Source: Ministry of Communications, Ukrchastotnagliad, Concorde Capital calculations
Note: Licenses are issued for 5 years in Ukraine and their prolongation costs 30% of the initial fixed payment

UMTS Fixed Costs per capita



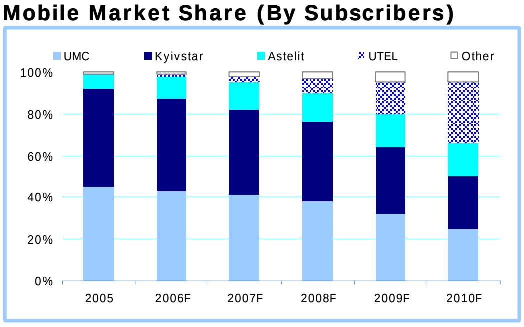
Source: Arthur Little Inc., IBM report

This new mobile license opens a whole world of new possibilities for UTEL, with good marketing the company could rapidly increase its subscriber base and revenues. The company's well developed data transmission network will make it easy for UTEL to launch its mobile network in short period of time.

UTEL Mobilizes Ambitious G3 Plan

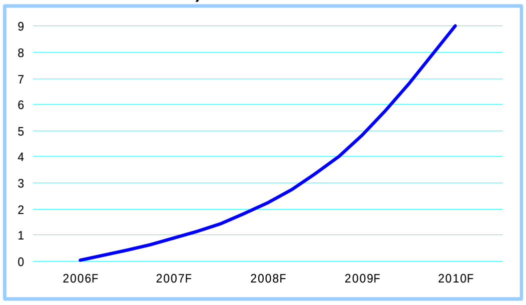
On February 2, 2006, UTEL announced its ambitious business plan for the development of its UMTS network:

Mobile Market Share (By Subscribers)



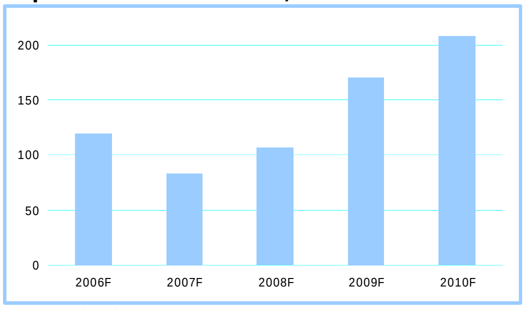
Source: Ukrtelecom

Subscriber Base, mln



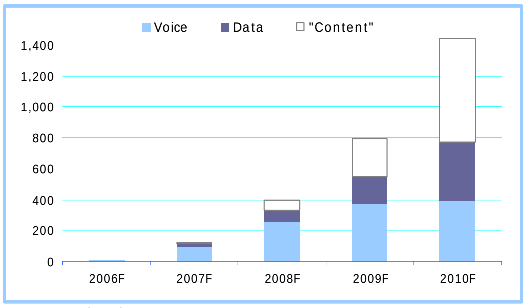
Source: Ukrtelecom

CapEx Into G3 Network, USD mln



Source: Ukrtelecom

Revenue Structure, USD mln



Source: Ukrtelecom

UTEL's Calculation Of NPV For Its Mobile G3 Project (USD mln)

	2006F	2007F	2008F	2009F	2010F
Sales	7.5	122	395.8	790.2	1,439.4
Less Operating Costs & DA	-49.1	-203.9	-297.8	-396.5	-523.9
Less Income Tax	0.0	0.0	-24.5	-98.4	-228.9
Plus D&A	24.6	62.2	66.3	90.7	127.5
Less CapEx	-119.6	-83.1	-106.3	-170.6	-207.9
Less Change In Working Cap.	0.0	-9.5	-22.8	-32.9	-54.1
FCFF	**-136.6**	**-112.3**	**10.7**	**182.5**	**552.1**

Source: Ukrtelecom, Concorde Capital calculations

NPV of the project: USD 182 mln (WACC=15%)

In the next section we look at the weaknesses in the company's plan.

Is UTEL's Plan Realistic?

1. Mobile CapEx: Looks Realistic

According to its plan, UTEL plans to spend USD 690 mln on the development of its mobile network in 2006-2010. The company is going to cover an area that comprises 70% of the population, and all major highways. Mobile operators on average pay about USD 100 ths for one node, however, UTEL already has the needed infrastructure (high-speed main network, extra capacity for equipment installation), therefore, the company's nodes will cost less. To cover the territory the company has set its sights on, UTEL will only need about 4,000 nodes, the actual launch of the company's mobile network will only use about half of UTEL's mobile budget. The remaining CapEx is likely to be spent on the creation of auxiliary systems.

2. Subscriber Base And Market Share: Too Optimistic

Good Starting Conditions…

UTEL is going to take advantage of its available fixed infrastructure to become a mobile leader in 5 years:

- Monopolistic access to the fixed last mile throughout Ukraine will allow the company to provide all telecom services (fixed & mobile telephony, internet, data transmission, digital TV etc.) to any citizen in any part of Ukraine
- Ownership of the fixed last mile means the company's costs for servicing calls between mobile and fixed customers will be lower, and UTEL can set lower tariffs compared to other mobile operators (the highest domestic tariffs are FTM and MTF tariffs)
- Because the company is the first in Ukraine to receive a G3 license, UTEL is in a good position to develop new mobile services, and it will be able to provide services which require high transmission capacity at much lower costs than GSM operators

For An Uphill Battle

However, the war for subscribers will not be cake walk:

The market the market is becoming more developed (mobile penetration already exceeds 66%), and will be occupied by two large operators (UMC and Kyivstar with more than 90% of the market) and one small but aggressive operator Astelit (currently, the most powerful competitor in UTEL's segment) by the time UTEL enters.

Second, in large cities (where UTEL plans to build its first base stations) CDMA operators are also going to have strong positions. So it will be hard for UTEL to come up with something special to entice customers away from its competitors. Another problem will be the fact that GSM handsets (already widely used) cannot be used in UMTS standard, meaning that customers will have to fork over quite a bit of money to shift from their GSM operator to UTEL.

Marketing, Marketing, Marketing

The key to UTEL's mobile success will be choosing the right marketing strategy. However, the company's current marketing department leaves a lot to be desired, as last year's results reflect: the company has proven it can build new networks and improve technical efficiency, but the company's efforts to attract new customers (in the internet and data segment) and to implement new services have flopped.

Case Study: Astelit - A Leader In Innovation

The best example of successful mobile development in Ukraine is Astelit, which started operating its GSM-1800 network in January 2005, and acquired 2.6 mln subscribers one year later. The company entered the market when almost all the potential mobile subscribers (the richest 30% of the population) had been divided between UMC and Kyivstar. Astelit overcame this obstacle by offering a wide range of additional services, including high speed data transfer technology (EDGE).

As UTEL is going to develop a network with higher data transfer capacities, its best bet would be to start by providing unique wireless data transfer services – to be one up on Astelit.

Thus, management's plan to increase the number of mobile subscribers to 2 mln in 2008 looks realistic, but only if they come up with a well thought out marketing strategy, something the current management has not proven itself capable of. The company's goal of attracting 9 mln of mobile subscribers by 2010 looks a bit more far fetched for two reasons:

- For it to happen, other GSM operators would basically have to stop developing their networks, coming up with new services and attractive tariffs

- If UTEL sets lower mobile-to-fixed connection fees (lower than for mobile operators) to attract new subscribers, the company may be accused of dumping (this has happened before, UTEL was charged with dumping after it reduced internet connection fees for its users below the tariff it charged for alternative IP providers).

3. Sales And Profits: A Bit Far Fetched

UTEL's projections of sales are even further from reality than the company's subscriber base projections:

ARPU: Seriously?

Currently the average ARPU for Ukrainian mobile operators is USD 10, UTEL has said it expects data and voice APRU of USD 16-18 in 2007-2008. In addition, UTEL forecasts a significant reduction of voice ARPU in 2009 and 2010, which means the company is going to transmit most of its traffic using data switching (VoIP). It is not clear why the company is not going to use VoIP for 3-4 years, and has no plans to go into the mobile sector offering this cheap product right off the bat.

Revenue Per User, According To UTEL Program, USD

	2006E	2007E	2008E	2009E	2010E
ARPU voice	35.0	15.8	12.7	8.1	4.3
ARPU data	2.5	2.8	3.6	3.9	4.3
ARPU content	0.0	1.3	3.2	5.2	7.4

Source: Ukrtelecom, Concorde Capital calculations

Content Segment: Pulling Our Legs?

The company's plans for the content services is possibly the most optimistic part of UTEL's plan: currently the company does not provide this service and has no plans to until 2006-2007, however UTEL's managers expect this segment to boom in 2009-2010, something we are highly skeptical of:

The global content experience suggests UTEL's plan is questionable:

- most of the revenue from content provision goes to small content providers rather than mobile operators
- data and additional services (like wireless e-mail and content provision) made up only about 1/3 of the world's leading G3 operator's (NTT DoMoCo, Japan) 2005 revenues. The remaining 2/3 is voice telephony. UTEL expects to get only about 27% from the voice segment in 2010.

These reasons coupled with the company's history of poor marketing make UTEL's plans look like quite a stretch. The state could regulate this market to the benefit of UTEL, but we do not think this is very likely nor would it be effective.

We have adjusted UTEL's program forecasts, to correspond more with trends on international G3 markets and UTEL' potential.

Forecasts Adjusted

We based our mobile sector forecast more conservative estimations of UTEL's market potential, and applied parameters from current Ukrainian mobile operators to UTEL's future earnings, taking into account that UTEL's costs for providing mobile services will be slightly lower than the current GSM operators.

Concorde Capital Key Assumptions

	2006E	2007E	2008E	2009E	2010E	2011E
Subs EoY, mln	0.05	0.70	1.90	3.50	5.00	5.9
ARPU, USD	14.0	11.0	12.0	12.5	13.0	13.0
EBITDA mrg	55%	54%	56%	57%	58%	58%

Source: Concorde Capital estimates

Concorde Capital NPV Calculations, USD mln

	2006E	2007E	2008E	2009E	2010E	2011E
Sales	4.2	53.5	202.4	426.3	697.9	873.6
Less Operating Costs & D&A	-26.5	-86.9	-155.4	-274.0	-420.6	-482.0
Less Tax	0.0	0.0	-11.8	-38.1	-69.3	-97.9
Plus D&A	24.6	62.2	66.3	90.7	127.5	115.1
Less CapEx	-119.6	-83.1	-106.3	-170.6	-207.9	-120
Less change WC	0.0	-4.1	-12.4	-18.7	-22.6	-14.6
FCFF	**-117.3**	**-58.3**	**-17.1**	**15.7**	**104.9**	**274.1**

Source: Concorde Capital estimates

NPV of the project: USD 22 mln (WACC=15%)

Despite using more conservative assumptions for UTEL's mobile market development in our model, we forecast a significant increase in the company's mobile revenues. We believe the mobile segment will be a key driving force behind the growth of UTEL's value, but the results will only be visible in the midterm.

We expect privatization and the entrance of a new strategic investor to cause some changes in the company's G3 plan, but overall UTEL's mobile strategy will remain the same. The more experienced and market savvy the international investor, the better UTEL's chances of reaching its goals.

EXPENDITURES

The company's current expense structure can be improved in two ways, as UTEL is characterized by high:

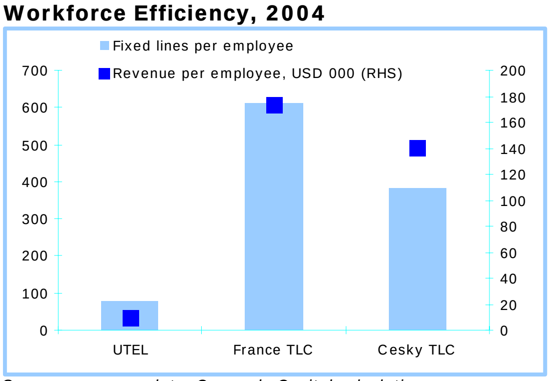
- Capital expenditures
- Expenses related to its workforce

Because of the company's exposure to the new segment, these costs are not expected to be reduced, but we can at least expect increased efficiency (return).

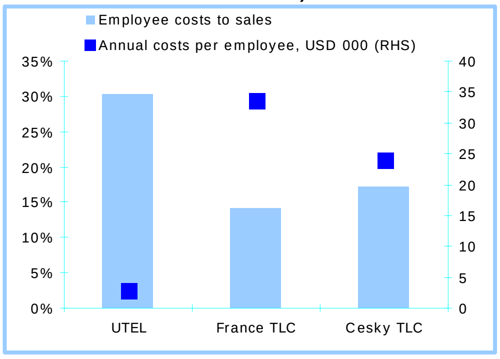
Workforce

UTEL has 5-7 times more employees per line than its western peers, thus optimization of the company's workforce structure could be powerful cost reducing measure. Currently the workforce cut is too low: CARG -1.3% during 1999-2004.

Workforce Efficiency, 2004



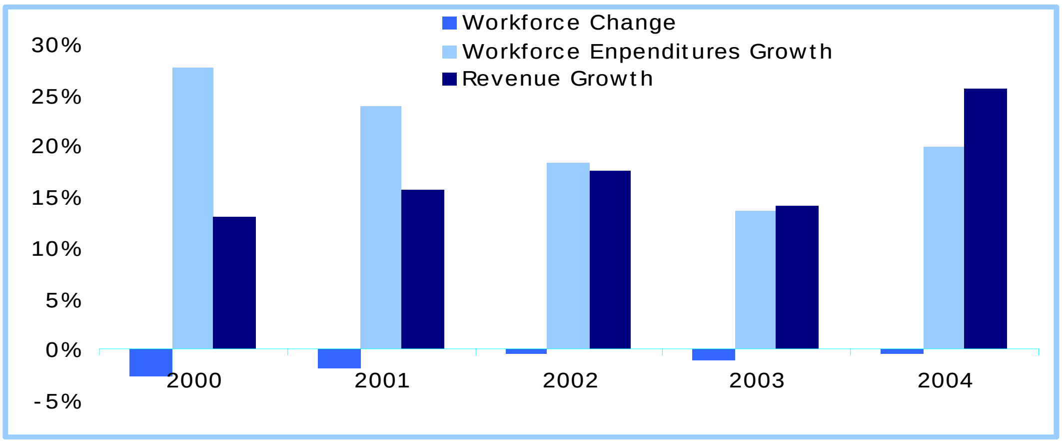
Workforce-Related Costs, 2004



Source: company data, Concorde Capital calculations

Such inefficiency is reflected in UTEL's relatively high employment-related costs, even despite the fact that annual expenditures per employee are more than 8x lower than for its western peers. However, with growth of average salaries in UTEL by more than 20%-25% p.a., employee-related expenditures are the fastest growing cost. In 2002-2004 employee-related costs grew at about the same rate as UTEL's revenue, so these costs did not affect the company's margins. However, with growing salary rate in Ukraine, and with slowdown of UTEL growth in 2005-2006, and constant employee policy, we can expect workforce costs to grow faster than revenues in the company during this period.

Changes In UTEL , YoY



Source: Ukrtelecom, Concorde Capital estimates

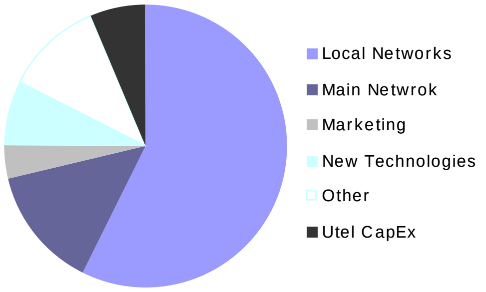
The two main reasons the company's workforce remains so large is the law on privatization of Ukrtelecom adopted in 2000 which prohibits significant restructures in the company before the privatization tender, and the application of outdated technical requirements in calculating workplaces needs in side the company. The former reason is no longer enforced, as the law on privatization was suspended this summer. Still, we doubt the workforce will be reduced in early 2006, as UTEL is expected to begin hiring for is mobile implementation project.

Thus, before privatization we doubt UTEL's work force will change significantly, which will mean further growth of labor-related expenses. After the privatization, the policy may be changed, as the experience of Cesky Telecom privatized by Deutsch Telecom, suggests: the company decreased its fixed line workforce by 36% in 2002-2004. We expect the same thing if the company is privatized by large international telecommunication company.

Capital Expenditures And Financing

In comparison to its sales and profits, the company has reported extremely large expenditures on equipment and line upgrades, however, in terms of money used for capital expenditures per single line, UTEL still lags to its western peers.

CapEx Targets, 2004*



Source: Ukrtelecom
** No data for 2005 available*

CapEx 2004: UTEL vs Peers

	CapEx / Line USD	CapEx / Sales	CapEx / EBITDA	ARPL USD
UTEL	45.8	37%	104%	10.4
France Tlc	50.5	11%	27%	39.0
Cesky Tlc	63.5	9%	18%	33.1
MATAV	68.9	15%	41%	37.3

Source: company data, Concorde Capital calculations

The main targets for the company's capital expenditures are local networks: the modernization of existing switching equipment by installing new digital exchanges. The company has installed new telephone exchanges with a total capacity 804,000 numbers in 2004, and only 25% of them were aimed at increasing UTEL's customer base – the others only changed old equipment. At the beginning of 2005, UTEL had 32.9% digital lines. The company prefers to digitalize its lines in large cities, which increases the quality of data and internet access services in the regions where they are in the highest demand.

Another important way the company used its CapEx was on the construction of a nation-wide fiber optic main network with DWDM technology. Construction of this network which finished in 2005, allows UTEL to provide a wide range of data transfer services to all consumers.

As the company's CapEx (expected about USD 450 mln in 2005) is almost the same as EBITDA, the problem of raising money for investments became an important issue. UTEL managed to take USD 250 mln loan from Deutsche Bank & Credit Suisse. The payback period for the loan is seven years (during the first three years only interest is paid); the interest rate is LIBOR +4.9%. This is less than the company's management hoped to attract (about USD 420 mln) but still is a good result taking into account current political pressure (former Minister of Transport opposed any loans to UTEL).

UTEL is going to spend an additional USD 690 mln to finance its extensive mobile set-up program. The company plans to attract loans for the first stage of the project: USD 140 mln in 2006 and USD 110 mln in 2007. However, we estimate the company will need additional external investments of about USD 145 mln in 2008-2010.

PRIVATIZATION

The privatization of UTEL, which was initially planned for 2000, and the last “deadline” was 2005, has been postponed for the following reasons:

- The arrival of the ‘orange government’ in early 2005 caused the revision of several old plans and the sacking of Tymoshenko’s government in September 2005 took the wind out of efforts to privatize UTEL in 2005.
- The absence of telecom sector regulation in 2H04-1H05 stopped the company from increasing its value before privatization. The inability to put the new tariff rebalance into place is the main hang-up here.

However, just about everyone from the Rada to the street says 2006 is *the* year.

Preparations

The government made its efforts to prepare UTEL for privatization public in August 2005, in order to increase the company’s capitalization before the tender. It granted the company a G3 mobile license, and has said it will approve a tariff rebalance (not yet done, refer to page 8), and elaborate on the rules concerning compensation for providing universal services (still on the drawing board).

We expect the government to make good on its tariff policy liberalization promise before the privatization - a significant break-through for the company, which should further spur interest in the company.

Privatization Legislation

In July 2005 the law *On the privatization of Ukrtelecom* (refer to description of this law in our December 2004 report) was suspended by the Rada, and currently there is no active law according to which the company can be privatized. At the moment, a draft of another law which stipulates conditions for UTEL privatization has been registered in the Rada.

The main point of the draft:
- Before privatization, the department of confidential state communication is to be separated from UTEL
- UTEL’s assets will be revalued and its charter fund will be adjusted accordingly
- The exact size of the state’s stake is not stated explicitly. However the draft says the state’s stake must not be fragmented
- UTEL is to be sold to a strategic investor, at open tender, with at least two participants
- The investor is not allowed to cut the work force by more than 10% annually
- UTEL is required to provide universal service until a compensation scheme is worked out
- All telecom tariffs are to be frozen for two years following privatization

This last statement definitely will send shivers up the spine of any potential investors – tariff rigidity is the company’s Achilles heel, and key reason for the rampant mobile cannibalization in Ukraine. For this reason we expect the Rada to cut some of these conditions from the draft when it is passed, however we do not expect this to happen until after the election monsoon season ends in April.

What Is UTEL Worth?

Ukrainian politicians value UTEL at around USD 3-8 bln, this figure is close to estimates implied from peer privatizations in CEE.

Telecom Sales, CEE

		Stake %	**Price** USD mln	**Mobile Segment**	**MCap / Lines****	**MCap / Sales****
2004	Bulgarian TC*	65.0	286	no	151	0.67
2003	Romtelecom*	19.2	173	no	220	1.02
2005	Turk Telekom	55.0	6,550	yes	624	2.50
2004	Svyazinvest	25.0	625	yes	83	2.58
2005	Cesky	51.2	3,588	yes	881	2.92
2004	Eesti Telekom	50.0	644	yes	2601	3.13
2004	TPSA	13.6	2,726	yes	1141	3.67
2005	Telecom Montenegro	51.1	152	no	1570	4.14
2002	Telekom Srbija*	29.0	204	yes	140	6.56
average					823	3.02
median					624	2.92
average (w/o ouliers)					1363	3.27

Source: company data, Concorde Capital calculations
** We consider these companies as outliers*
*** Sales and subscriber base are taken for the year preceding acquisition;*

Implied UTEL Privatization Price, USD mln

	By Average Multiple		**By Average Multiple w/o Outliers**	
	MCap USD mln	**Share price** USD	**MCap** USD mln	**Share price** USD
MCap/Sales	3,624	0.19	3,921	0.21
MCap/Lines*	15,382	0.82	11,270	0.60

Source: Concorde Capital calculations
** MCap/Lines do not account for the number of mobile subscribers; therefore, implied UTEL value is over-priced by this multiple*

However, a great deal will depend on regulatory changes and the company's prospects at the moment of privatization: tariff rigidity and universal service obligations, will continue to plague UTEL's attractiveness and affect the sale price.

What Benefits Will Privatization Bring To UTEL?

We expect the company's strategic investor to usher in a new marketing system that will aim at strengthening the company's positions in the most profitable telecom service segments (VoIP, Internet access and data transfer, universal services to corporate clients, and mobile telecommunication).

In addition, we can expect workforce optimization and the optimization of CapEx programs which would lead to decrease in UTEL's spending.

We doubt any new profit-oriented investor would continue developing low-margin segments like fixed rural telephony, payphones and radio/telegraph services provision.

The re-allocation of the company's recourses to the segment with higher returns will increase UTEL's margins in the midterm.

In addition, the fact that UTEL is being privatized with all its networks reduces the threat of unbundling: unbundling is impossible before privatization (because it would reduce UTEL's capitalization), and it is unlikely the new strategic investor would allow the company's assets to be carved up.

VALUATION

Peer Comparison

No matter how you look at it, Ukrtelecom is over-valued compared to its international peers, however, comparable valuation does not account for the company's mid-term growth which will be fueled by its entry into the mobile segment.

The effect of mobile sector development will only be visible in 2009-2010, and this cannot be accounted for using peer valuations. Therefore, in our analysis we will rely more on our DCF model.

International Peers: Key Data (USD mln)

	Sales			Net Income			EBITDA			Fixed Lines mln	ARPL USD	Margins,2004:	
	2004	2005E	2006E	2004	2005E	2006E	2004	2005E	2006E			Net	EBITDA
Cesky Telecom	2,404	2,456	2,543	218	240	311	1,172	1,113	1,156	3.47	31.8	9%	49%
Magyar Telecom	2,955	2,884	3,015	170	350	393	1,040	1,169	1,220	2.83	54.7	6%	35%
Bezeq	2,069	2,370	2,390	139	173	172	871	842	875	3.01	57.3	7%	42%
Telemar	5,153	7,465	7,864	303	809	914	2,241	3,020	3,211	15.20	28.3	6%	43%
TP SA	5,478	5,623	5,851	661	632	680	2,622	2,513	2,541	11.25	27.3	12%	48%
Bulgarian Tlc	651	645	677	159	157	161	268	261	270	2.91	18.6	24%	41%
median											31.8	9%	42%
average											38.5	13%	42%
Ukrtelecom	1,147	1,242	1,442	142	120	170	402	379	491	9.80	9.8	12%	35%

Source: company data, Concorde Capital estimates

Valuation Using International Peers

	Price USD	MCap	EV	EV/S			EV/EBITDA			P/E			EV/Lines USD
				2004	2005E	2006E	2004	2005E	2006E	2004	2005E	2006E	
Cesky Telecom	21.28	7,349	7,969	3.3	3.2	3.1	6.8	7.0	6.7	33.7	30.6	23.6	2,296
Magyar Telecom	4.67	5,099	6,975	2.4	2.4	2.2	6.7	6.0	5.3	30.0	14.6	13.0	2,465
Bezeq	137.34	3,599	4,670	2.3	2.0	1.9	5.4	5.5	5.2	26.0	20.9	20.9	1,551
Telemar	17.66	7,598	11,584	2.2	1.6	1.3	5.2	3.8	3.1	25.1	9.4	8.3	762
TP SA	7.22	10,553	12,135	2.2	2.2	2.1	4.6	4.8	4.8	16.0	16.7	15.5	1,079
Bulgarian Tlc	6.27	1,824	1,796	2.8	2.8	2.7	6.7	6.9	6.8	11.5	11.6	11.3	617
mean				2.5	2.3	2.2	5.9	5.7	5.3	23.7	17.3	15.4	1,462
median				2.3	2.3	2.1	6.0	5.8	5.3	25.5	15.6	14.2	1,315
Ukrtelecom	**0.21**	3,932	4,229	3.7	3.4	2.9	10.5	11.2	8.6	27.6	32.8	23.2	432
Implied Upside (at median)				-36%	-35%	-31%	-41%	-52%	-43%	-8%	-52%	-39%	225%
Implied Target, USD				**0.13**	**0.14**	**0.15**	**0.12**	**0.10**	**0.12**	**0.19**	**0.10**	**0.13**	**0.68**

Source: company data, Bloomberg, IBES, Concorde Capital estimates

Russian Peers: Key Data (USD mln)

	Sales		Net Income		EBITDA		Customers mln	ARPU USD	Margins,2004:	
	2004	**2005E**	**2004**	**2005E**	**2004**	**2005E**			Net	EBITDA
Central Tlc	867	947	13.8	25.9	220	171	6.39	11.3	2%	25%
Northwest Tlc	533	700	46.1	76.4	128	130	3.50	12.7	9%	24%
Volga Tlc	646	734	71.4	67.6	137	n/a	4.32	12.5	11%	21%
Southern Tlc	582	628	9.6	8.6	156	175	3.90	12.4	2%	27%
Uralsvyazinform	837	1,011	73.6	67.0	279	294	5.71	12.2	9%	33%
Sibir Tlc	661	744	22.3	39.0	165	222	5.10	10.8	3%	25%
Dalsvyaz	310	353	39.7	33.9	94	103	1.41	18.3	13%	30%
MGTS	520	631	65.3	97.5	181	167	4.33	10.0	13%	35%
average							4.33	12.5	8%	28%
Ukrtelecom	1147	1254	142.4	150.0	402	435	9.54	10.0	12%	35%

Source: company data, Concorde Capital estimates

Valuation Using Russian Peers

	Price USD	MCap	EV	EV/S		EV/EBITDA		P/E		EV/Lines USD
				2004	2005E	2004	2005E	2004	2005E	
Central Tlc	0.61	963	1,738	2.01	1.84	7.9	10.2	69.7	37.1	272
Northwest Tlc	1.10	969	1,134	2.13	1.62	8.9	8.7	21.0	12.7	324
Volga Tlc	4.15	1,021	1,377	2.13	1.88	10.1	n/a	14.3	15.1	319
Southern Tlc	0.15	444	1,128	1.94	1.80	7.2	6.4	46.2	51.5	289
Uralsvyasinform	0.04	1,195	1,722	2.06	1.70	6.2	5.9	16.2	17.8	301
Sibir Tlc	0.08	1,009	1,286	1.95	1.73	7.8	5.8	45.3	25.9	252
Dalsviaz	2.85	272	322	1.04	0.91	3.4	3.1	6.9	8.0	228
MGTS	20.50	1,636	1,772	3.41	2.81	9.8	10.6	25.1	16.8	409
mean				2.08	1.79	7.7	7.2	30.6	23.1	299
median				2.03	1.76	7.8	6.4	23.1	17.3	295
Ukrtelecom	0.21	3,932	4,229	3.7	3.4	2.9	10.5	11.2	8.6	27.6
Implied Upside (at median)				-45%	-48%	-25%	-42%	-17%	-47%	-32%
Implied price				**0.12**	**0.10**	**0.16**	**0.11**	**0.18**	**0.11**	**0.15**

Source: company data, RTS, Concorde Capital estimates

DCF Model

Assumptions

The model implements our assumptions about fixed line market growth in line with the tariff rebalance expected in 2006, and the mobile segment assumptions mentioned on page 25.

Basic Model Assumptions, UAH mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
GDP growth	9.0%	12.0%	2.4%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Industrial prod. growth	14.0%	12.5%	3.1%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

Ukrtelecom Revenues Forecast

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Local Growth		*13.5%*	*-0.3%*	*47.6%*	*3.5%*	*3.5%*	*3.0%*	*2.0%*	*1.0%*	*1.0%*	*0.5%*	*0.5%*
Local Revenue, mn UAH	**1210**	**1326**	**1322**	**1951**	**2019**	**2090**	**2153**	**2196**	**2218**	**2240**	**2251**	**2262**
ILD growth			*-8.8%*	*-3.5%*	*-3.0%*	*-2.0%*	*-2.0%*	*-1.5%*	*-1.0%*	*-0.5%*	*0.0%*	*0.0%*
ILD revenue	**864**	**840**	**766**	**660**	**640**	**627**	**615**	**606**	**600**	**597**	**597**	**597**
FTM revenue growth		*3.5%*	*25.0%*	*17.0%*	*7.0%*	*5.0%*	*6.5%*	*6.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
FTM revenue	**398**	**1558**	**1947**	**2278**	**2437**	**2559**	**2726**	**2889**	**2976**	**3065**	**3157**	**3252**
DLD growth		*-33.6%*	*-9.0%*	*-14.0%*	*-6.0%*	*-3.0%*	*-2.0%*	*-1.0%*	*-1.0%*	*0.0%*	*0.5%*	*0.5%*
DLD revenue	**923**	**613**	**558**	**480**	**451**	**438**	**429**	**425**	**420**	**420**	**422**	**425**
LD growth			*8.6%*	*4.5%*	*3.2%*	*2.7%*	*4.0%*	*4.0%*	*1.9%*	*2.2%*	*2.3%*	*2.3%*
LD revenue	**2185**	**3011**	**3271**	**3418**	**3529**	**3624**	**3769**	**3919**	**3996**	**4082**	**4176**	**4273**
Data growth		*34.4%*	*20.7%*	*19.0%*	*12.0%*	*10.0%*	*7.5%*	*4.0%*	*3.0%*	*3.0%*	*2.0%*	*2.0%*
Data Revenue	**259**	**348**	**420**	**500**	**560**	**616**	**662**	**689**	**709**	**731**	**745**	**760**
Mobile growth						*278.3%*	*108.4%*	*63.8%*	*25.1%*	*7.5%*	*4.5%*	*3.5%*
Mobile Revenue				**21**	**270**	**1022**	**2130**	**3490**	**4365**	**4692**	**4904**	**5075**
Termination growth		*22.0%*	*20.0%*	*21.8%*	*8.0%*	*6.0%*	*4.0%*	*3.0%*	*2.0%*	*1.5%*	*1.0%*	*1.0%*
Traffic termination rev.	**554**	**676**	**811**	**988**	**1067**	**1131**	**1176**	**1212**	**1236**	**1254**	**1267**	**1280**
Rent growth		*13.3%*	*4.9%*	*-3.5%*	*-4.0%*	*-1.0%*	*0.0%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*
Rent& intn'l transition	**527**	**597**	**626**	**604**	**580**	**574**	**574**	**583**	**591**	**600**	**609**	**618**
Other	**116**	**113**	**110**	**110**	**110**	**110**	**110**	**110**	**110**	**110**	**110**	**110**
Total growth		***25.2%***	***8.1%***	***15.7%***	***7.2%***	***12.7%***	***15.3%***	***15.4%***	***8.4%***	***3.7%***	***2.6%***	***2.3%***
TOTAL REVENUE	4,851	6,071	6,560	7,592	8,135	9,168	10,575	12,198	13,225	13,710	14,062	14,379
EBITDA margin, %	46.5%	35.1%	30.5%	34.0%	37.0%	38.5%	41.5%	43.1%	43.7%	44.0%	44.2%	44.2%

Source: Ukrtelecom data, Concorde Capital estimates

UTEL's WACC to perpetuity10%, which is close to the WACC of CEE peers (8.5%-10%)

Perpetuity growth rate: 3%

Model Output And Recommendations

For the purposes of forecasting local currency is used

	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
EBITDA	**2,015**	**2,602**	**3,034**	**3,553**	**4,413**	**5,292**	**5,814**	**6,072**	**6,259**	**6,403**
EBIT	1,144	1,632	1,977	2,399	3,148	3,919	4,358	4,547	4,677	4,773
Tax Rate	*30%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*
Taxed EBIT	801	1,224	1,483	1,799	2,361	2,939	3,268	3,410	3,507	3,580
Plus D&A	871	971	1,057	1,154	1,266	1,373	1,456	1,525	1,583	1,630
Less CapEx	(2,188)	(2,670)	(2,311)	(2,488)	(2,738)	(2,677)	(2,239)	(2,020)	(1,822)	(1,640)
Less change in OWC	(1,315)	40	(3)	(67)	(80)	(20)	(47)	(22)	(87)	(16)
FCFF	**-**	**-**	**226**	**398**	**808**	**1,615**	**2,439**	**2,893**	**3,181**	**3,553**
WACC	15.4%	14.3%	13.5%	13.0%	12.4%	11.9%	11.4%	11.5%	11.5%	11.6%

Terminal Value (22 Feb 2007): UAH **21,373** mln
Enterprise Value (22 Feb 2007): UAH **29,238** mln
Equity Value (22 Feb 2007): UAH **26,031** mln

Portion Due to TV: **73.1%**
Implied Exit EBITDA multiple: **8.2x**

Fair Price for an ordinary share (22 Feb 2007): USD 0.256

Even though we have taken a more conservative view in our assumptions about the company's growth than UTEL's management, our DCF model implies a 22% upside. Therefore, we upgrade our recommendation to **BUY**.

Financial Statements Summary, According To Ukrainian Accounting Standards

Income Statement Summary, USD mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Net Revenues	**910**	**1,146**	**1,242**	**1,442**	**1,545**	**1,741**	**2,009**	**2,317**	**2,512**	**2,604**	**2,671**	**2,731**
Change y-o-y	*N/M*	*26%*	*8%*	*16%*	*7%*	*13%*	*15%*	*15%*	*8%*	*4%*	*3%*	*2%*
Cost Of Sales	(396)	(654)	(758)	(836)	(859)	(946)	(1,034)	(1,158)	(1,243)	(1,281)	(1,309)	(1,338)
Gross Profit	514	493	485	606	686	796	974	1,158	1,269	1,323	1,362	1,393
Other Operating Income/Costs, net	(27)	(20)	(24)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)
SG&A	(65)	(70)	(82)	(94)	(93)	(104)	(121)	(139)	(151)	(156)	(160)	(164)
EBITDA	**423**	**402**	**379**	**491**	**572**	**670**	**833**	**999**	**1,097**	**1,146**	**1,181**	**1,208**
EBITDA margin, %	46.5%	35.1%	30.5%	34.0%	37.0%	38.5%	41.5%	43.1%	43.7%	44.0%	44.2%	44.2%
Depreciation	(125)	(153)	(164)	(183)	(199)	(218)	(239)	(259)	(275)	(288)	(299)	(307)
EBIT	**297**	**249**	**215**	**308**	**373**	**453**	**594**	**739**	**822**	**858**	**882**	**901**
EBIT margin, %	32.7%	21.7%	17.3%	21.3%	24.1%	26.0%	29.6%	31.9%	32.7%	32.9%	33.0%	33.0%
Interest Expense	(9)	(26.9)	(31)	(49)	(62)	(73)	(74)	(81)	(80)	(77)	(69)	(66)
Financial income/(expense)	21	34	28	28	18	15	15	19	23	26	26	26
Other income/(expense)	(55)	(31)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)
PBT	**254**	**225**	**184**	**259**	**301**	**366**	**506**	**649**	**736**	**779**	**812**	**833**
Tax	(110)	(82)	(64)	(91)	(105)	(128)	(177)	(227)	(258)	(273)	(284)	(292)
Effective tax rate	*43%*	*37%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*
Extraordinary Income/(loss)	(0.1)	0.0	-	-	-	-	-	-	-	-	-	-
Net Income	**145**	**142**	**120**	**169**	**196**	**238**	**329**	**422**	**479**	**506**	**528**	**542**
Net Margin, %	*16%*	*12%*	*10%*	*12%*	*13%*	*14%*	*16%*	*18%*	*19%*	*19%*	*20%*	*20%*
Dividend Declared	**27**	**143**	**48**	**67**	**78**	**95**	**132**	**169**	**287**	**304**	**448**	**487**

Balance Sheet Summary, USD mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Current Assets	**391**	**379**	**485**	**512**	**544**	**561**	**633**	**718**	**779**	**807**	**828**	**847**
Cash & Equivalents	87	82	149	144	155	118	121	139	151	156	160	164
Trade Receivables	133	135	162	166	170	192	221	255	276	286	294	300
Inventories	74	81	87	101	111	129	151	162	176	182	187	191
Other current assets	96	82	87	101	108	122	141	162	176	182	187	191
Fixed Assets	**1,358**	**1,515**	**1,787**	**2,074**	**2,342**	**2,617**	**2,897**	**3,202**	**3,366**	**3,478**	**3,503**	**3,507**
PP&E, net	1,118	1,263	1,528	1,812	2,057	2,325	2,597	2,869	3,039	3,165	3,218	3,224
Other Fixed Assets	240	252	259	261	285	292	300	333	326	313	286	283
Total Assets	**1,748**	**1,894**	**2,272**	**2,586**	**2,886**	**3,178**	**3,529**	**3,920**	**4,144**	**4,285**	**4,331**	**4,353**
Shareholders' Equity	**1,416**	**1,376**	**1,557**	**1,679**	**1,797**	**1,940**	**2,156**	**2,409**	**2,601**	**2,803**	**2,882**	**2,936**
Share Capital	878	878	878	878	878	878	878	878	878	878	878	878
Reserves and Other	293	497	603	623	623	623	642	642	642	642	642	642
Retained Earnings	245	0	72	174	291	434	631	884	1,076	1,278	1,357	1,411
Current Liabilities	**212**	**371**	**300**	**342**	**377**	**425**	**532**	**622**	**650**	**662**	**634**	**643**
ST Interest Bearing Debt	35	49	44	47	60	68	121	147	135	128	100	97
Trade Payables	62	108	93	107	114	129	149	171	186	193	198	202
Accrued Wages	8	10	14	16	17	19	22	25	28	29	29	30
Accrued Taxes	20	14	12	14	15	17	20	23	25	26	13	14
Other Current Liabilities	115	334	137	159	170	192	221	255	276	286	294	300
LT Liabilities	**121**	**147**	**415**	**564**	**712**	**813**	**841**	**889**	**894**	**820**	**815**	**774**
LT Interest Bearing Debt	108	136	402	536	679	780	806	860	872	805	800	759
Other LT	13	11	13	27	33	33	35	29	22	15	15	15
Total Liabilities & Equity	**1,748**	**1,894**	**2,272**	**2,586**	**2,886**	**3,178**	**3,529**	**3,920**	**4,144**	**4,285**	**4,331**	**4,353**

Cash Flow Statement Summary, USD mln

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Net Income	145	142	120	169	196	238	329	422	479	506	528	542
Depreciation	125	153	164	183	199	218	239	259	275	288	299	307
Non-operating and non-cash items	59	6	231	45	(26)	(24)	19	(66)	(23)	(26)	19	(1)
Changes in working capital	51	167	(247)	8	(1)	(13)	(15)	(4)	(9)	(4)	(16)	(3)
Operating Cash Flow	380	469	267	404	369	419	572	611	722	764	829	845
Capital Expenditures, net	(314)	(419)	(412)	(478)	(436)	(469)	(517)	(505)	(422)	(381)	(344)	(309)
Other Investments, net	(29)	16	-	-	-	-	-	-	-	-	-	-
Investing Cash Flow	(342)	(404)	(412)	(478)	(436)	(469)	(517)	(505)	(422)	(381)	(344)	(309)
Net Borrowings/(repayments)	8	43	260	136	156	110	78	81	(1)	(74)	(33)	(44)
Dividends Paid	(42)	(66)	(48)	(67)	(78)	(95)	(132)	(169)	(287)	(304)	(448)	(487)
Other	6	(48)	-	-	-	-	-	-	-	-	-	-
Financing Cash Flow	(28)	(71)	212	69	77	14	(53)	(88)	(288)	(378)	(482)	(532)
Beginning Cash Balance	N/A	87	82	150	144	155	118	121	139	151	156	160
Ending Cash Balance	87	82	149	144	155	118	121	139	151	156	160	164
Net Cash Inflows/Outflows	9	(6)	67	(5)	10	(36)	2	19	12	6	4	4

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.

Stock Price And Target Price History, USD

Alexander Paraschiy

Date	Closing Price, USD	Target Price, USD
22-Feb-05	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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