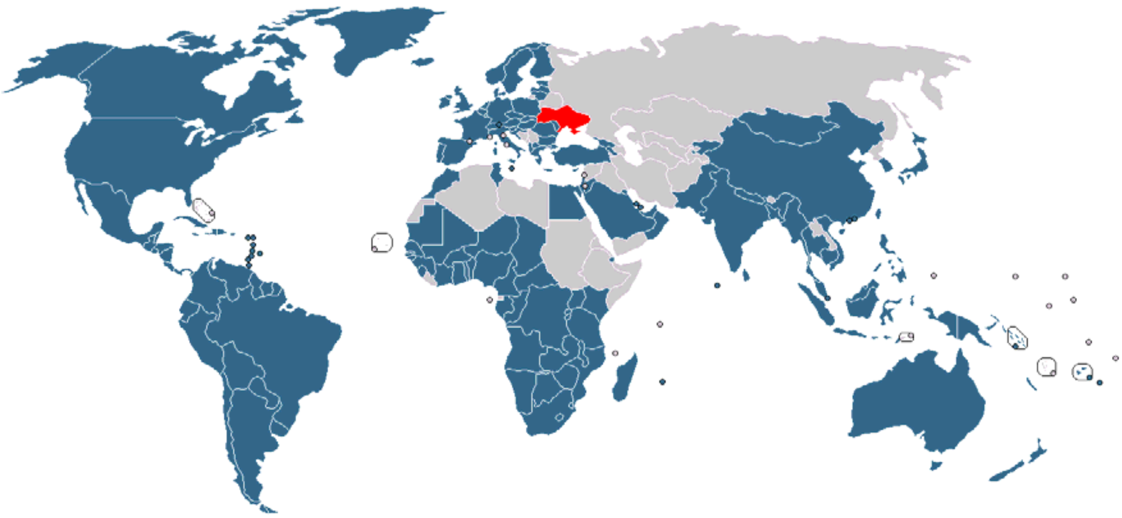
WTO welcomes Ukraine's accession



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Winners and losers

Positive

Grain
Steel
Pipes
Chemicals
Oil & Gas
Pharmaceuticals
Financial Services
Ferroalloys
Iron Ore, Coke
Dairy Products
Sugar
Ship Building & Aerospace
Auto Manufacturers
Steam Coal
Telecom Cables
Meat
Textile
Housewares

Negative

On February 5, the General Council of the World Trade Organization approved Ukraine's accession. The Verkhovna Rada has to ratify the deal by July 4, 2008, making the country an official member 30 days thereafter.

After 14 years of negotiations, entry marks a significant milestone and allows negotiations on a Free Trade Agreement with the EU to start immediately.

Admission provides access to the markets of 151 WTO members and increases negotiating power in trade disputes. Universally recognized rules for trade and investment will provide a degree of certainty and stability to prop up FDI. The resulting reduction in country risks begs sovereign rating upgrades: we see up to a three notch potential.

- Cancellation of quotas and discriminatory measures will benefit exporters that can utilize a low labor cost advantage such as steel producers, and the chemical industry.
- Leverage in trade talks with Russia, which is seeking WTO membership, will help Ukraine soften barriers to the Russian market.
- The comprehensive positive effect on the economy can be quantified as an added 1.5% to 2.4% to annual GDP growth over the next five years.
- Strong FDI inflows expected: USD 11 bln in 2008, and at least USD 50 bln over 2008-2012.
- Consumers will benefit from the broader availability of higher quality goods & services for lower prices.

- We estimate the current account deficit will not widen to more than 5% of GDP in 2008, with a gradual reversal starting from 2009.
- Corporate profitability may suffer in the short-term, as producers will face an urgent need to invest in improving productivity and quality to maintain competitiveness.

Outcomes of increased competition:

- Forced acquisitions in the pharmaceutical sector – watch potential takeover targets: Darnitsa, Kyivmedpreparat, Farmak.
- Consolidation in food processing to bolster competitiveness against a flood of cheap imports. Several strongly positioned consolidators: Milkiland (heading for IPO) in the dairy sector; Dakor, Astarta, Ukrros among the traded sugar producers.
- Emergence of large modern agricultural companies; inflow of capital into agribusiness. Look at Land West, which floated in Nov. 2007, and Agricole to be placed in February
- Strategic partnerships by local auto-makers with world majors to maintain their market shares (ZAZ, Bohdan).

Companies to watch

Darnitsa (4SI1 GR: BUY)
Kyivmedpreparat (KMED: N/R)
Farmak (FARM: N/R)
Milkiland
Dakor (DAKOR: U/R)
Astarta (AST PW: N/R)
Ukrros (UROS: N/R)
LandWest (4K1A GR: N/R)
MCB Agricole Holding
ZAZ
Bohdan (LUAZ: N/R)
Odeskabel (OCAB: U/R)
Chernigiv Khimvolokno (CHIM: BUY)
Galnaftogaz (GLNG: U/R)
Stirol (STIR: BUY)
Nord (NORD: U/R)

Key economic data

	2007	2008E	2009F
Real Economy			
GDP real growth, %	7.3	6.8	6.5
Nominal GDP, USD bln *	140.5	177.3	207.9
Industrial output growth, %	10.2	9.8	7.5
CPI (eop), %	16.6	15.2	10.0
PPI (eop), %	23.2	18.0	9.5
Foreign activity			
FDI inflow, USD bln*	9.0	11.0	15.0
Total Exports, USD bln*	63.4	77.4	94.5
Total Imports, USD bln*	69.9	88.6	105.0
Trade Balance, USD bln*	-6.5	-11.2	-10.4
Current Account, % GDP*	-3.6	-5.5	-4.7
NBU Reserves, USD bln	32.5	38.0	48.0
Monetary & Fiscal Policy			
Economy Monetization, %	46.5	51.2	60.1
Money Supply Growth, %	51.7	30.0	40.0
UAH/USD (eop)	5.05	5.00	4.90
Consolidated Budget, % GDP	-1.1	-1.2	0.5

Note: Concorde Capital estimates for 2007: official data pending
Source: NBU, Ukrainian Statistics Committee, Concorde Capital estimates

Calendar

Feb. 12:	Ukraine-Russia summit
Feb. 17:	EU FTA talks launch
Jul. 4:	Deadline to ratify Accession Package

Ukraine gets all WTO advantages

The price of the membership looks worth paying for

WTO membership involves some financial and economic adjustment costs. However, the tools that Ukraine gets in terms of its developmental impact will definitely pay off, similar to previously acceding countries.

Market access

As a WTO member, Ukraine is accorded permanent Most Favored Nation status. The MFN moniker, a cornerstone of WTO trade law, guarantees equal and indiscriminate treatment between WTO trade partners (if one member extends trade advantages to another, it must also do so to all other members). Under this principle, Ukrainian exporters will have a level playing field in terms of tariff charges and trade benefits.

Cancellation of quotas

Upon accession, Ukrainian goods will not be subject to any import quotas, as well as other restrictive non-tariff measures as stipulated in WTO agreements.

Reduction in antidumping measures

According to UNDP findings, anti-dumping actions have a significantly lower incidence rate against WTO members. Metallurgy and chemicals, key Ukrainian export industries, which have traditionally suffered from these constraints, will benefit the most from an improved trade environment.

Dispute settlement process

Ukraine, whose economy is geared tightly to international trade, will gain access to an impartial and binding dispute settlement mechanism that has a track record of efficiently resolving grievances between WTO members.

Stable and universally understandable policies

Adherence to WTO rules goes hand-in-hand with stable commercial policy – a boon to domestic producers and importers alike. This encourages investments and job creation while ensuring consumers can fully enjoy the benefits of competition. Entry confirms that the Ukrainian legal environment conforms to international standards in terms of intellectual property rights, international trading practices, quality standards, etc.

First milestone in integration chain

Next step – Free Trade Agreement with the EU

Ukraine views WTO accession as the first step toward closer integration with the EU. A Free Trade Agreement (**FTA**) with the EU, which Brussels had conditioned on WTO membership, will be the next major milestone. Now that Ukraine is in, FTA talks are scheduled to commence February 17, 2008. Taking the experience of past negotiations as a guide, we see final settlement in 2009. The bilateral agreement will bring about abolition of merchandise import and export duties, and liberalized trade in services.

Ukraine's declared long-term aim is full EU membership. The next intermediate targets after an FTA are an Extended Partnership Agreement (**EPA**) and Associated Membership (**AM**). Successful completion of these stages could ultimately lead to a spot in the European Union.

Ukraine's European Agenda

These integration advances create the institutional background for tighter economic cooperation between Europe and Ukraine, which has already been progressing at a good clip: the EU's share in Ukraine's total FDI stock increased from 56% in 2003 to more than 76% in 1H07, while trade over the same period surged almost threefold to USD 30 bln.

Macro impact: moderately positive

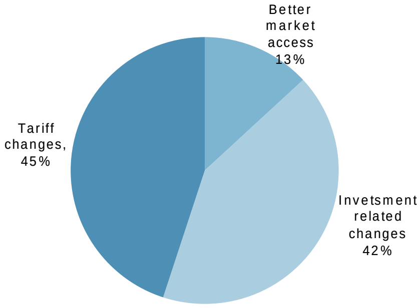
The general consensus is that WTO accession will have an overall positive and comprehensive effect on the economy over the mid to long term, adding, according to different estimates, from 1.6% to 2.4% to GDP growth.

Assessments of the WTO membership impact on the economy

Source	Impact on GDP
Presidential Administration	+1.60%
Ministry of Economy	+1.75%
Institute for Economic Research and Policy Consulting	+2.40%

Of the WTO-related factors that will impact GDP growth, experts evaluate access to other markets as a relatively less powerful contributor, with most of the positives coming from a more open investment environment and tariff reductions.

WTO-related factors adding to GDP growth



Source: Institute for Economic Research and Policy Consulting

FDI will be stimulated, especially into services

The WTO legal framework provides for the free flow of direct investments into the economy. Examples of this includes: the list of prohibited investment regulations (like demand for obligatory local component in production), requirement to cancel caps on foreign share in capital of local companies. We expect the opening of Ukrainian markets for financial and transportation services, communications, and tourism will stimulate capital inflows into the economy, with a healthy shove along the way from the European Football Championships to be held in Ukraine in 2012. Estimated annual FDI will be USD 10-15 bln over the next three years.

Impact on external trade

While total trading volumes are poised to grow after accession, we estimate the net impact on external trade to be rather muted, with extra exports counteracting increased imports. A rise in imported pharmaceuticals, polymer materials, housewares and food products in the low-price segment will be immediately visible. On the other hand, grain exports will grow, while domestic prices, contrary to many other sectors, will adjust upward (current wheat price differential is an artificial 30%: USD 257/mt domestically vs. USD 366/mt global).

In the long run, chemicals, metallurgy and agriculture will be the major industries benefiting from Ukraine’s WTO membership.

Budget revenues will not suffer

In 2007, import and export duties amounted to a mere 8.2% of consolidated budget receipts. Upon WTO entry, the average import tariff rate will only decrease by an estimated 0.2 pp, as most of the tariffs were already reduced prior to accession. Therefore, the effect will not be sizable. Moreover, as tariffs fall, trade will accelerate, compensating any slight tariff rollback.

Sector Overview

Sector	WTO-related changes	Comments	Impact: Short-term	Impact: Long-term
Auto manufacturers	Reduction in the import duty for passenger cars from 25% to 10% without any transition period	Booming demand for cars in Ukraine will temper the effect of the reduced duty as car retailers will be reluctant to mark down prices	Slightly Negative	Neutral
	Reduction in the import duty for trucks from 20% to 10%	Domestic producers' prices will still remain competitive; Russia is the main export destination		
	Reduction in the import duty for new buses from 20% to 10-15%	Ukrainian producers will remain price-competitive, export-oriented to CIS countries		
Shipbuilding & Aerospace	Abolishment of government support programs for both industries	Grants over the last three years were negligible, not exceeding USD 1 mln for shipbuilding and USD 5 mln for the aerospace industry	Neutral	Neutral
Telecom cables	Import duty for telecom cables changed from 20% to zero	In recent years, **Odeskabel (OCAB)** was suppressed by a "shadow import" of telecom cables, thus the effect of the official abolition of the import duty is not expected to be pronounced	Negative	Negative
Chemicals	Fertilizer producers: No changes in short-term, all antidumping measures against Ukrainian exporters remain in effect	WTO provides efficient tools to challenge barriers for Ukrainian exports. The probability of abolishing these antidumping measures in the near term goes up	Neutral	Positive
	Organic chemicals: Import duties for polymers and rubber decreased from 5-20% to 0-6.5%	Negative effect on local polymer producers, mainly **Chernigiv Khimvolokno (CHIM)** and **Stirol (STIR)**, due to higher competition on the local market. Slightly negative for tire makers, which already suffer from increasing imports, the mitigating factor being lower cost imported rubber. In the longer term, we see a positive effect for CHIM, as we expect Ukraine to bargain for reduced trade barriers with Russia (CHIM's main export destination), which is also targeting WTO accession		
Pharmaceuticals	Reduction of import duties from 0-20% to zero	**Negative**: Removal of barriers will trigger increased imports, which already account for ~75% of local consumption. Negative for Ukrainian producers (**Darnitsa (4SI1 GR), Kyivmedpreparat (KMED), Farmak (FARM)**, etc) **Positive**: Higher competition will catalyze M&A activity in the sector. We expect all sizable local producers to sell out in 3-5 years to global majors who will bring their technologies and distribution force	Mixed	Positive
	Improvement of property rights protection	**Negative**: Production of generic copies of products patented abroad will become problematic. Previously, local legislation did not put any sanctions on Ukrainian companies producing copies of foreign products for patents that had not expired **Positive**: One more reason for local companies to sell out		
Oil & gas	Revival of import duties for oil products now less probable	Positive for independent oil and gas retailers like **Galnaftogaz (GLNG)**	Neutral	Positive
Financial Services	Ban lifted on opening foreign branches in banking and insurance	Facilitates new entries from abroad, increasing pressure on local margins. However, we do not expect many newcomers, as global players already control half of the market. Heavyweights that are still out of Ukraine are likely to hold until certain market maturity and will be entering in the mid-term	Neutral	Positive
Steel scrap	Export duty for scrap will be reduced from 30 EUR/mt to 10 currently EUR/mt six years after WTO accession	**Positive:** Producers of steel scrap will benefit from lowered export barriers by redirecting their shipments to more price-attractive markets abroad **Negatives:** Scrap is already in short supply in Ukraine - domestic smelters will feel additional cost pressure, which will further translate to steel pipes	Mixed	Mixed

Sector	WTO-related changes	Comments	Impact	
			Short-term	Long-term
Steel	Export quotas for steel to the EU and US will be eliminated in 2008 (quota to EU: 1.3 mln mt or 5% of total exports; quota to US: 0.15 mln mt of cut to length HR steel or 0.5% of total exports)	**Positive:** The elimination of quotas opens up the possibility to increase exports (in 2007 quotas were 70-90% exploited depending on the product). Leverage in trade talks with Russia, as a WTO aspirant, will help soften barriers to the Russian market **Risks:** Quite high probability that eliminated quotas will be replaced by antidumping duties	Neutral	Positive
Steel Pipes	No changes	All non-Russian antidumping duties for Ukrainian pipes will most likely remain in effect for the mid-term. Leverage in trade talks with Russia, as a WTO aspirant, will help Ukrainian producers soften barriers to the Russian market	Neutral	Positive
Steam Coal	Removal of implicit subsidization of state-owned steam coal mines	**Negatives:** Accession to WTO will put downward pressure on domestic prices for steam coal **Positives:** Privatization must come to the agenda	Negative	Neutral
Ferroalloys	No changes	Antidumping duties for Ukrainian alloy exports to North America will most likely remain in effect in the mid-term. Shortages in supply forced Russia and the EU to cancel their antidumping measures against Ukraine in Nov. 2007	Neutral	Positive
Grain	Gradual abolishment of export quotas	The government's attempts to preserve low bread prices with export quotas for grains has kept Ukraine's export potential (of 4-5 mln mt in 2007/2008) unrealized	Positive	Positive
Sugar	Currently, all sugar imports face a 50% duty, but not less than EUR 300/mt From 2009, 260 ths mt of raw cane sugar per year can be imported at a 2% tariff; everything in excess at 50%	As most Ukrainian sugar producers have capacities to process raw cane sugar, they will adjust their area under beet cultivation to account for imports of raw cane sugar. Availability of imported raw cane sugar will smooth sharp price fluctuations on Ukraine's sugar market	Neutral	Neutral
Dairy products	Change in tariffs from specific to ad-valorem: 10% of customs value	**Short-term**: Prices of Ukrainian diary products will still be competitive domestically compared to EU products. Last year the EU, due to WTO obligations, cancelled export subsidies for its dairy producers **Long-term**: We expect that after investing into raw milk production, Ukrainian producers will be able to meet Europe's strict sanitary requirements and start exporting to the EU	Neutral	Neutral
House wares	Reduction in import duties for refrigerators from 5-50% to 5-10%	Inflow of cheap refrigerators from Russia and Turkey will threaten **Nord's (NORD)** market share, whose refrigerators are positioned in the low-price segment	Negative	Negative

Source: WTO, Verkhovna Rada of Ukraine, Concorde Capital research

Appendix

Trade restrictions abroad for metallurgy, mining and chemicals

Currently under investigation

Product	Destination	Date of initiation of investigation	Expected date of conclusion	Sales in 2006, USD mln
Pipes	Mexico	2006	-	0.94
Stainless pipes	Russia (not a member of the WTO)	2007	Dec. 2008	n/a
Polyamide technical yarn*	Russia (not a member of the WTO)	2007	Oct. 2008	10.7

**Company affected: CHIM*

Existing duties

Product	Importing country	Current duties	Effective from	Year of revision	Expected removal
Cut to length HR	US	Azovstal : 81.43%, MMK Illicha: 155%, other: 237.91%	1966	2002, 2005	2008
	Mexico	60.1%	2003		2010
HR coil	US	90.33%	2000	2006	2012
	Canada	63.0%	2001	2005	2011
	Thailand	MMK Illicha: 32.17%, other: 71.52%	2002		2008
	Argentina	360 USD/mt FOB	1998	2004	2010
	Venezuela	62.92%	1998	2004	2010
	Mexico	46.66%	1999	2005	2011
CR coil	Argentina	71.22%	2001	2004	*2008
	Venezuela	55.01%	1998	2004	2010
HR & CR coil	Peru	7208: 24.10%-31.49%, 7209.27: 59.45% (included after revision)	1999	2001	2006
Semis	Turkey	10.8% (17 USD/mt), after revision 4 USD/mt	1994	*2000, 2006	
Rebar	US	41.69%	2000	2006	2012
	Mexico	30.5%	1999	2005	2011
Wire rod	US	116.37%	2007		*2011
Ferrosilicomanganese	US	163.0%	1993	1999, 2005	2011
	Mexico	51.28%	2002		2008
SD & MD pipes	Russia	Well casing: 11.4%, bearing: 55.3%, tubing: 18.1%, OCTG (hot deformed, diameter <820): 8.9% (MMK Illicha – 0%), boiling: 11.3%	2004		2011
Seamless pipes	EU	Dnipropetrovsk Pipe: 12.3%, Nikopol Seamless Pipes, Nyzhnoydniprovsk Pipe: 25.1%, UTiST, other: 25.7%	2006		2011
Welded pipes	EU	Novomoskovsk Pipe: 30.9%, other: 44.1%	2001		*2007
LD pipe	Russia	Special duty: 8%	2006		2010
Urea	US	68.26%	1986	1999, 2004	2010
	EU	EUR 8.85-16.84/mt	2002	*2006	2008
Ammonium nitrate	US	156%	2000	2006	2012
	EU	EUR 29.26-33.25/mt	1999	2006	2009
	Brazil	19%	2001	*2007	2008
Urea-ammonium nitrate mixtures (UAN)	EU	EUR 27.17/mt	1999	2005	2011

** Currently under revision*
Source: Ministry of Economy

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