Yasynivsky Coke

Good Time To Buy

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Market: USD 0.37
Target: USD 0.73
Upside: 93%

In their quest to make a story out of nothing, some Ukrainian press' speculation about Yasynivsky Coke's (YASK) agreement with MMK Illicha (MMKI) has recently knocked down YASK's price to USD 0.37 per share. We believe this speculation is ungrounded and stick to our prior target price of USD 0.73 per share, which implies an appealing upside of 93%. We reiterate BUY.

Latest news provoked bad talk about YASK

On March 13, 2007, the Antimonopoly Committee of Ukraine (AMC) permitted Donetskstal and MMK Illicha to create a joint venture, Yasyniv Coke Company Ltd. The announcement unleashed journalistic speculation that Yasynivsky Coke's two coke batteries will be stripped and transferred to the JV. The upheaval in the media is, in our view, unfounded and casts the deal in an obscure light. The recent AMC announcement was no big surprise: the market has been aware, for quite a while, that MMK Illicha and Yasynivsky Coke have been mulling some kind of partnership. In 2006, with very limited information available to the market, the deal was mistakenly characterized as a "lease".

The application to create the JV was probably submitted as early as a year ago – right after MMK Illicha agreed to directly receive coke shipments from Yasynivsky Coke's two coke batteries (owned by Donetskstal group) in January 2006.

The liaison: Our view

We believe the purpose of the JV is to put the owners of MMK Illicha and Yasynivsky Coke's minds at rest around the issues of coke prices for MMK Illicha and stable coke shipments for Yasynivsky Coke. The deal looks like a win-win: MMK Illicha covers 50-55% of its needs for coke; Yasynivsky Coke secures a stable market for about 70% of its output. We think, initially MMK Illicha had bargaining power: back in 2005, Yasynivsky Coke lost almost 25% of coke sales due to an influx of cheaper Chinese coke to Europe and the deal would safeguard it against a further drop in production.

However, later on, the balance of power started shifting. First, in April 2006, Yasynivsky Coke improved the quality of its coke, which created opportunities to expand their market, even in Ukraine. Second, the threat of Donetsk Coke closing (since October 2006) put MMK Illicha on the edge of losing 7-10% of its coke supply. Additionally, since the second half of last year, coking prices started climbing, increasing MMK Illicha's concerns about cost inflation.

We think the agreement between Yasynivsky Coke and MMK Illicha was structured in a way that resembles a mid-term contract. The JV appears not to foresee the transfer of rights for cash flows from coke sales from Yasynivsky Coke to MMK Illicha. Our hypothesis is supported by the strong 9M06 sales reported by Yasynivsky Coke, which showed impressive 12.5% yoy growth.

Donetskstal - No sale or asset stripping

We talked to Donetskstal's top management just two days ago. They confirmed to us that the group's strategy does not envisage the sale or stripping of Yasynivsky Coke's coke batteries. We believe Donetskstal group, which owns Yasynivsky Coke and the leading CIS producer of high quality hard coking coal, Chervonoarmiyska-Zakhidna mine, plans to develop Yasynivsky Coke by switching to highly demanded high-grade coke, supplies of which are limited in Ukraine (only 7% of total Ukrainian coke production in 2006) due to a lack of quality inputs.

In our view, the creation of the JV simply reflects the *status-quo* between Donetskstal and MMK Illicha, and it does not impose extra risks to Yasynivsky Coke's minority shareholders.

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