

March 21, 2012

Zakhidenergo, Dniproenergo

Speculative buys on put option opportunity

We assign speculative BUY recommendations to Zakhidenergo and Dniproenergo on an attractive opportunity created by the decline in the price of both shares since announcement of their AGMs. In order to realize this opportunity, minority shareholders can obtain a put option by voting against a “significant deals” item at the upcoming AGMs. With the option’s strike price 18% higher than the current offer price for Zakhidenergo and 11% higher for Dniproenergo, investors can earn 77-224% annualized yield to put on their investment.

Put option mechanism based on “significant deals vote”

Shareholders can obtain the right to sell shares back to issuers by voting against a “significant deals” item at the companies’ AGMs, a mechanism we termed the temporary embedded put option, TEPO (see our earlier desk note dated March 1). Shareholders have 30 days after the AGM to exercise their option and the issuer has 30 days thereafter to pay. The option’s strike price cannot be less than the market price on the date before the AGM announcement, which implies a minimum strike price for Zakhidenergo of UAH 245.8/share and for Dniproenergo of UAH 699.4/share. The minimum strike price, therefore, is 18% higher than the current price for Zakhidenergo and 11% higher for Dniproenergo, suggesting an attractive speculative opportunity.

Speculative BUYs assigned

Assuming shareholders realize their TEPOs, the implied annualized return based on the current price for Zakhidenergo is 224% and for Dniproenergo is 77%. We note that the window for this opportunity is open for just two more days for Zakhidenergo (shareholders as of March 22 are eligible to participate in the AGM) and for two weeks for Dniproenergo (the AGM record date is April 4). We assign speculative BUY recommendations to both stocks.

Other shares with TEPO opportunity

The following companies also have a “significant deals” item on the agendas for their upcoming AGMs. Some also represent a TEPO opportunity, yet expected profit is less pronounced than for Zakhidenergo and Dniproenergo. We note that the key beneficiaries of several of these companies, notably Metinvest and DTEK, have high corporate governance standards and we believe are certain to follow the letter of the law. We also list a series of companies where opportunities might appear if share prices decline (denoted in grey) – their AGM agendas also include a “significant deals” item but their last deal price currently exceeds the estimated strike option.

		AGM date	Est. strike price, UAH	Last price, UAH*	Upside to put	Days to settle**	Annualized yield to put
Yenakieve Steel	ENMZ	30-Mar	66.13	62.74	5%	54	43%
MMK Ilicha Steel	MMKI	23-Apr	0.26	0.25	4%	78	21%
Azovstal	AZST	26-Apr	1.36	1.32	3%	81	13%
Komsomolets Donbasa	SHKD	04-Apr	1.22	1.45	0%	59	0%
Khartsyzsk Pipe	HRTR	11-Apr	1.19	1.21	0%	66	0%
Kyivenergo	KIEN	12-Apr	6.50	8.00	0%	67	0%
Central Iron Ore	CGOK	19-Apr	8.10	8.17	0%	74	0%
Northern Iron Ore	SGOK	19-Apr	11.91	11.90	0%	74	0%

*Prices as of March 20, 2012. ** Based on the assumption settlement takes place 45 days after the AGM
 Source: Company data, UX, Concorde Capital estimates

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Zakhidenergo

AGM date	March 28
AGM record date	March 22
Expected div. yield	0.9%
Expected TEPO strike price	UAH 245.8
Current price*	UAH 207.9
Return on TEPO	18%
Annualized return	224%

Dniproenergo

AGM date	April 10
AGM record date	April 04
Expected div. yield	2.3%
Expected TEPO strike price	UAH 699.4
Current price*	UAH 631.8
Return on TEPO	11%
Annualized return	77%

*Prices as of March 20, 2012

Source: Company data, UX, Concorde Capital

FAQs on TEPO

How can shareholders obtain a TEPO?

Shareholders that register for the AGM and vote against the “significant deals” item automatically get a TEPO, according to Ukrainian legislation. The put option is valid for 30 days after the AGM vote. Shareholders that do not vote against “significant deals” do not obtain a TEPO.

How long does the issuer have to settle?

The issuer has to buy back shares within 30 days of notification that a shareholder wants to execute the TEPO.

What is the strike price under the TEPO?

According to legislation, the strike price cannot be less than the market price prior to the announcement of the AGM that has the “significant deals” item on its agenda. The last deal price prior to the announcement date is the best indicative “market price” for listed securities.

What is a “significant deal”? In this context

– it is a deal/contract signed by a company that exceeds 25% of total assets as of the last reporting year. All these deals/contracts are subject to approval at a company’s AGM.

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