



Analyst's Notebook

Ukraine / Ferroalloys
 September 1, 2006

SFER: BUY, TP: USD 0.007, +130%
ZFER: BUY, TP: USD 0.16, +60%

Ferroalloy Makers' 1H Results Justify Our Buy Recommendations

Market Still Undervalues Ferroalloy Makers

Zaporizhya Ferroalloy (**ZFER: BUY**) and Stakhanov Ferroalloy (**SFER: BUY**) came through with excellent 1H06 results, just as we forecasted. We believe these results will spur the market to better appreciate both companies and lift their stock prices towards our target prices. We reiterate our targets: USD 0.16 for ZFER and USD 0.007 for SFER, based on DCF modelling. Which imply upsides of almost 60% for ZFER and 130% for SFER.

ZFER and SFER Report Robust 1H06 Financials

Zaporizhya and Stakhanov Ferroalloy, both controlled by the Privat business group, posted healthy financials for 1H06, despite weaker ferroalloy prices (see the table below). We expect the companies' full-year results will be in line with our forecasts thanks to stronger domestic and world steel markets and reduction of transfer pricing and cost inflation (see our reports of June 30 and August 18).

Bulk Ferroalloy Prices, USD per mt

Hong Kong Prices	1H05	1H06	YOY, %	2005	2006E	YOY, %
SiMn	782	615	-21%	692	675	-2%
FeSi	658	635	-3%	632	640	1%
FeMn	852	651	-24%	734	650	-11%

Key Operating & Financial Results

ZFER	1H05	1H06	YOY, %	2005	2006E	YOY, %
Output, ths mt	242	254	5%	472	516	9%
Sales, USD mln	159	152	-4%	316	332	5%
EBITDA margin, %	-7%	8%		2%	15%	
Net margin, %	-8%	5%		-1%	8%	

SFER	1H05	1H06	YOY, %	2005	2006E	YOY, %
Output, ths mt	112	95	-15%	205	219	6%
Sales, USD mln	46	61	33%	93	127	37%
EBITDA margin, %	-5%	7%		-1%	8%	
Net margin, %	-9%	3%		-6%	1%	

Source: Bloomberg, Company Data, Concorde Capital estimates and calculations

ZFER Accelerates Production

We believe Privat group has redirected a larger share of its export orders to ZFER, which out-produces SFER and has a broader product profile. This allowed ZFER to increase output by 5% yoy to 254 ths mt. Sales dropped slightly to USD 152 mln on the back of decreased prices in 1H06 compared to 1H05.

SFER's Improved Top Line Stems From Reduction of Transfer Pricing

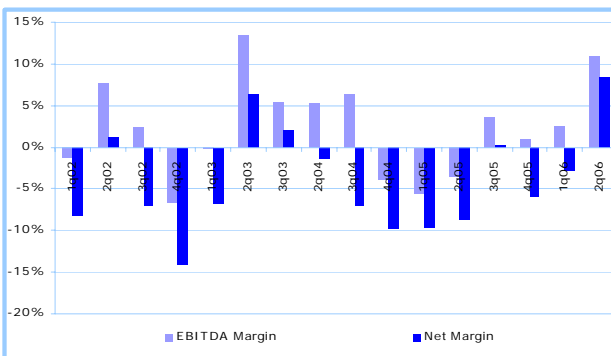
We believe SFER's strong sales, totaling USD 61 mln (up 33% yoy), stem mainly from reduction of transfer pricing. In 1H06 the company decreased ferroalloys output to ~110 ths mt with the reduction of FeSi output by 56% yoy to 34 ths mt, while SiMn production grew to 65 ths mt (up 41% yoy) in 1H06, as we anticipated. We expect total output will increase in 2H06 thanks to the awakening domestic steel market.

Profit Margins Continue Improving

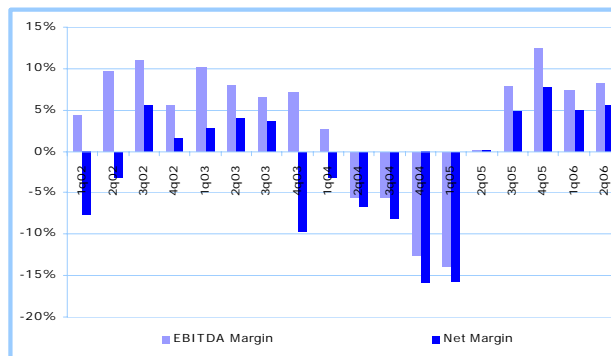
In 2Q06 SFER and ZFER continued phasing out shady schemes (see our reports of February 2 and April 19). This process explains the positive margin dynamics over the last few quarters (see the charts below). Both producers reported robust margins in 1H06. SFER's EBITDA margin jumped to 7% in 1H06 from -5% in 1H05, while its net margin improved to 3% compared to -9% in 1H05. ZFER's margins also grew yoy in 1H06: EBITDA climbed to 8% from -7% in 1H05 and net margin rose to 5% from -8% in 1H05.

Profitability Margins:

SFER*



ZFER



Source: Company Data, Concorde Capital estimates
*In 4Q03-1Q04 SFER temporarily stopped production

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