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Analyst's Notebook

Ukraine / Metallurgy
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****Editor's Note:** The Analyst's Notebook is Concorde Capital's fast response tool for keeping our coverage of the Ukrainian market as up to date as possible. Unlike our more in-depth desk notes and reports, Analyst's Notebook provides rapid feedback on breaking news in the Ukrainian market. Analyst's Notebook gives you our analysts' first impressions of a situation and may set the table for further investigation. Our analysts will use their experience in their sectors to take a look at the situation and provide insight or speculate on possible scenarios. We want to emphasize however, this product consists mostly of the analyst's intuition and may require further analysis.

Zaporizhstal To Dilute Minority Shareholders?

Rumors Stopped The Market Dead In Its Tracks

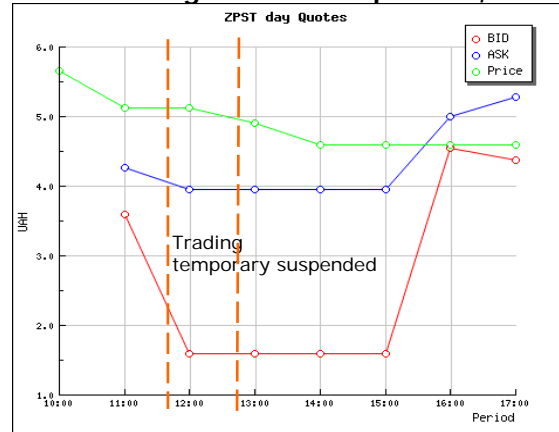
Western investors, fresh from their Easter holiday's, were shocked when DRs on ordinary shares in Zaporizhstal lost 10.5% on April 18th and another 11.7% on the 19th, on high volumes. Locally, the PFTS even had to suspend trading in the stock for one hour on April, 19th.

GDR's price Frankfurt (1:10)



Source: Frankfurter Boerse

Quotes Changes as of 19 Apr 2006, UAH



Source: PFTS

All the turbulence was the market's violent negative reaction to the share issue rumors. Even though mid-market prices on the PFTS only decreased to 0.95 USD on April 19th, intra-day bids shrank to 0.34 USD, lower than the market price after adjustment for the additional share issue.

A Bomb On The Agenda

The company plans to triple its charter fund from USD 42 mln to USD 131 mln at its EGM on June, 7 2006. The shares of the additional emission will be exchanged for the 100% stakes in the company's trading houses assuming that ZPST's shareholders are offered no subscription rights. Those who vote against this decision will have the right to sell their stakes to the company at par value (USD 0.05). Whatever the reasons behind the share issue, for minority shareholders the dilutive effect of the possible capital increase will exceed 60%.

Is There Any Silver Lining?

Zaporizhstal is known for its transfer pricing. Investors were waiting for good news - more transparency and consolidation of cash flows. Consolidation is a nice word, however, the way it is going to be conducted will do little to increase transparency. Zaporizhstal sells more than 80% of its output abroad through its affiliated offshore companies. The transfer pricing schemes allow the company to pump 20% to 30% of Zaporizhstal's profits out behind the backs of minority shareholders. The company's five trading houses work mostly on the domestic market with end users, without using off-shore transfer pricing games. **So, this current shake up will do nothing to get rid of value distortion.**

As the consolidation will be non-cash, the question is: will the dilution be compensated by offsetting increases in production assets or expected incremental profits?

The answer to the first part of the question is **NO**. The five companies are trading vehicles – their fixed assets are not even slightly comparable to Zaporizhstal.

The answer to the second part of the question is also **NO**. None of the five trading houses post margins above Zaporizhstal itself, so the marginal effect of the consolidation will not be positive. At first glance aggregated sales of the five companies represent nearly one-third of ZPST's revenues, however, this number is deceiving. Revenues connected to Zaporizhstal products will be netted out in the consolidated statements. Further, most of the revenues from two of the companies are in fact ZPST's costs – and will be netted out as well. 'Still Trek' sells scrap metal to ZPST and TH Vognetriv is a supplier of refractory products. Our back-of-the-envelope calculations show that though net margins could increase by 1%-3% in consolidated statements, it is obviously not enough to offset the massive share price dilution.

Interim Results for 9 months of 2005

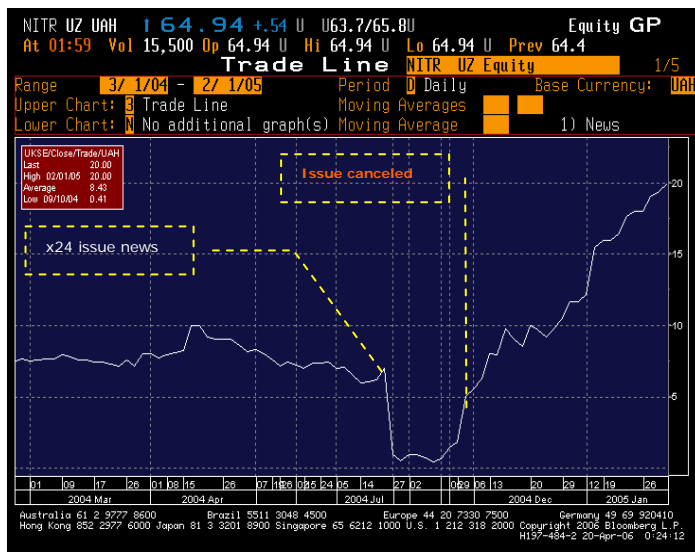
Company	Sales USD mln	Net margin	Export Share	Business Focus
Trading House ZPST	116.9	6.1%	2.7%	Selling ZPST's products domestically
Centrostal LTD	102.0	3.5%	0.0%	Selling ZPST's products domestically
Zapopizh-Invest-Torgprom	4.4	2.2%	13.2%	Selling ZPST's products domestically
Stil Trek	93.9	0.5%	0.3%	ZPST metal scrap supplier
Trading House Vognetriv	62.8	7.8%	6.9%	ZPST flux supplier
ZPST	1,205	8.6%	84.3%	

Source: Company Data, Concorde Capital estimates

On a positive note, 'Stil Trek' is the third largest scrap metal operator in Ukraine. Having this segment consolidated, with global and local demand for scrap posed to grow, is good news for shareholders. However, this is just a spoonful of sugar in a bitter ocean.

Market participants look set to try to defend their rights in court, however, from our vantage point this endeavor looks like it has a snowball's chance in hell. Their best bet may be to pray that major shareholders change their minds.

Watch Out - Have We Seen This Before?



Source: Bloomberg

Doesn't this remind you of NITR's emission story? In late 2004, NITR's major shareholders hurt the company's market price by using an additional share issue hoax. On July, 7 2004, the company announced a roughly 2.5-fold additional share issue. Later on August, 27 the volume was radically changed and envisaged a 24-fold emission. The charter fund was supposed to be increased from 2.5 USD mln to 59 USD mln. That day NITR's MCap collapsed by 84% and the stock was even temporary excluded from the PFTS index. Later at their EGM shareholders voted for an additional share issue. The market was frightened and allowed major shareholders to purchase their shares and draining free float. In the end, on November, 30 2004, the company canceled the emission. After

the dust settled, NITR's price started to pick up speed and in the end showed significant growth.

We refuse to give up hope, but are **SUSPENDING** our recommendation and will be following the situation closely.

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