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Smart Investor

Das Magazin für den kritischen Anleger

SUPPLEMENT

Ukraine

Investing in growth, buying the future

in cooperation with

RG SECURITIES AG
Wertpapierhandelsbank

CONCORDE CAPITAL

Including analyses of the Ukrainian economy, Ukrnafta and other blue chips, small and mid caps with high growth potentials, real estate and dairy sector, upcoming IPOs; interview with an expert on Eastern Europe

EDITORIAL

On its way westward

Ralf Flierl, Editor-in-chief

Tobias Karow, Project Manager

Smart Investor is well known for looking beyond its own nose – the Ukraine seems to be in line with this. Those who believed, the Orange Revolution would have been the end of a special kind of development, now look hocused. The country seems to be situated in the middle of a fundamental breakup: Political strength comes back, the economy is prospering, and an existing perspective for joining the EU – many facts not only pin on Ukrainian people's hopes, but arguing for a better future for the largest country in this area.

In this context the supplement „Ukraine – Investing in growth, buying the future" has been set up. It is necessary analyzing the chances Ukraine's equity markets offer for an investor, but also the risks. Besides these procedure contributes reducing timidness of investing in Ukrainian stocks. Special thanks go to RG Securities, senior lead broker for Ukrainian stocks at the Frankfurter Wertpapierbörse, and notably to Ekaterina Shumskaya, project manager of the Ukraine supplement. We also thank locally sited Concorde Capital, who delivered the high quality research for the issue. Last but not least, special thanks go as well to Deutsche Börse AG which helped tieing links between the German and Ukrainian stock markets. According to this, Ukraine will show itself at the Eigenkapitalforum taking place from 27th to 29th of November 2006. By this means Ukraine takes a further step forward to foreign investors. Smart Investor wants to go along with Ukraine at an early stage and asks its readers to act on with this. Finally we want our readers to have an exciting time by reading the Ukraine supplement.

FOREWORD

Welcome to Europe

By Dr. Martin Steinbach and Stefan Höfer, Deutsche Börse AG

Dr. Martin Steinbach, Director, Head of Section Issuer Relations, Stock Market Business Development

Stefan Höfer, Key Account Manager Russia&CIS, Issuer Relations, Stock Market Business Development

European integration has brought the member countries closer together and provided prosperity and boom. The process of integration still bears high attraction – shown e. g. by the Ukraine`s interest to join. The perspective to become member of the EU creates positive effect on the transformation of politics and economy. Especially Ukrainian companies are interested to get a listing at a European stock exchange. With good reason: When listed, the companies have access to European investors, enhance their net assets, competitive position and international presence. Not only big companies can have these benefits, also young growth enterprises in the early stage of their development.

Deutsche Börse offers exactly this attractive and direct access to the European capital market. Already 38 Ukrainian companies are listed. The stocks come mainly from the real estate, telecommunication, software, and commerce verticals.

The Ukraine as the center of attraction represents the growing interest for the Eastern neighbour in the conference "Eigenkapitalforum" at the end of November 2006, held by Deutsche Börse and KfW Mittelstandsbank in Frankfurt. At November 28th the country forum "Ukraine" will take place. 8 companies will present to more than 4.000 investors and analysts. The focus will be on corporate financing, floating and economic developments.

Deutsche Börse also acts locally. For example last April and May we presented our services at the Spring Conference of Concorde Capital and at the Capital Market Conference of Dragon Capital in Kiew. Deutsche Börse offers an attractive package – different trading segments with different reporting requirements.

Ukrainian companies can choose between three segments – Entry Standard, General Standard and Prime Standard. They address the needs of the particular investors and enterprises and accompany the issuers on their entrepreneurial progress.

Ukraine – diversified investment chances

The Ukraine is a special place to invest. But after the Orange Revolution it offers a lot of perspectives and opportunities to those investors who take time in analysing the economic environment and the political situation. Read the introduction beginning on page 6.

The dynamic dairy and real estate sector

Beside the large and small caps Ukraine has two sectors with an actually very dynamic development. The analyses up from page 17 give an overview of the sectors and announce two interesting companies going for an IPO in 2007.

Interview with Stefan Laxhuber

Stefan Laxhuber is one of the investors who belong to the group of the first movers. In his view now Ukraine could build the next success story in the Eastern European emerging markets. What else he expects from the country – read page 21 et sqq.

Imprint

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Source: Ostinvestor (Stefan Laxhuber), Marina Martirosyan (Concorde Capital)

Ukrainian Market overview

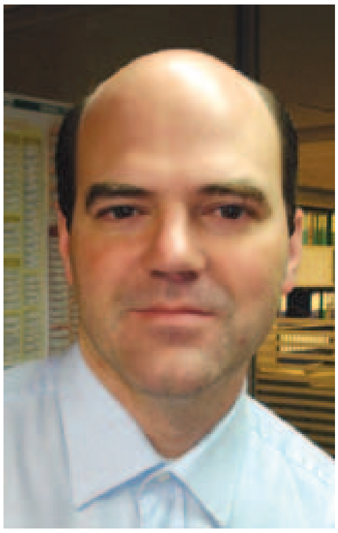
Winding its way upward

Attention shifts to banking and energy sectors; transparency of the accounts matters

by Tom Warner, Concorde Capital

The Ukrainian stock market's movements this year have been turbulent, but stepping back and looking at the longer-term trend (see chart), it's clearly still a bull market. At the end of October the PFTS index was up 18,2% since the start of the year, and up 23,4% over the past 12 months. The index started this year at around 350, and using the trade corridor marked on our chart as a guide, the index looks likely to end the year at around 450.

This year's dramatic political events are often cited as the explanation for the stock market's jerky movements. In the early part of the year, the market was hoping, and betting, that March parliamentary elections would yield an "orange-blue" coalition joining the pro-western president, Viktor Yushchenko, and his more Russia-friendly former rival, Viktor Yanukovich. The PFTS index climbed from around 350 to around 450 by May, breaking out of the trade corridor. As hope for that outcome waned, the index sagged to below 400, where it stayed until late July. Then in August the alliance materialized, but Yanukovich was in a stronger position than expected, and some of his initial moves weren't well received. The PFTS index rallied in August to around 425, then dipped back below 400 in September, and then returned to growth in October, ending the month at 417,23.



Tom Warner

But domestic political events probably matter much less than is widely believed. The PFTS index's movements this year closely followed those of Russia's RTS index and Morgan Stan-

ley's MSCI EM index (see chart). Clearly, emerging market fund movements are at least as important as domestic factors in driving changes in the valuations of Ukrainian stocks. This year's major event was the retreat from emerging markets in May, as global markets figured that higher interest rates and a predicted slow-down in global growth next year could weigh particularly heavily on capital-hungry developing economies. The bearishness has passed, but caution remains.

Banking and energy stocks excel

Ukraine's stock market has traditionally been dominated by heavy industry, especially steel and power generation. In recent years, however, the market has been steadily broadening as companies from other sectors have joined the market or become more actively traded. In August-October, banking stocks accounted for 21,7% of reported trading in Ukrainian companies on the PFTS and Frankfurt exchanges, while metallurgy accounted for 16,7% of reported volumes, excluding private placements and illiquid stocks, whose reported volumes can be very erratic. In 2005, metallurgy stocks accounted for 24% of combined PFTS and Frankfurt volumes, while banking stocks ac-

Tab. 1: Economic data Ukraine	
Inhabitants in mln	46,5
Area in sq km	603.700
Demographic structure*	16,6 / 28,6
GDP growth 2006e	6,4%
GDP per capita 2006 (in USD)	2.085
Export share	36,0%
Inflation rate 2006e	10,0%
Inflation rate 2007e	9,8%
Unemployment rate 2006e	7,0%
Unemployment rate 2007e	7,5%
Trade balance, in % of GDP 2006	6,2%
Budget balance, in % of GDP 2006	2,9%
Credit rating (S&P)**	BB-
Key interest rate	8,5%
Foreign direct investments, USD bln	3,5%
IEF-Ranking***	99

*part of the over 65years old inhabitants of complete employable population in 2006/2050; **S&P-Rating shows the credit standing of the Ukraine; ***placement in the 161 countries enclosing 2006er ranking of economic freedom, published by the heritage foundation, brings together in one indicator the level of economic freedom and the wealth of the country (Sources: Ukrainian Government, Economist Intelligence Unit, Bloomberg, Foyil estimates)

Ukr. companies traded in Germany	WKN
Anhousa Ltd.	A0B BNP
Avtokraz	A0J DUG
AZOT Open Joint Stock	915 709
Azovstal	920 308
Centrenergo	A0B L6W
Centrenergo	914 631
Galnaftogaz	A0F 4YW
Crimean Soda Plant	A0H 1BV
Dniproazot	A0E AG3
Dniproenergo	920 560
Dniprokoks	A0J DUJ
Dniproshyna	A0J DUL
Donetsk Steel Works	A0D QFT
Bank Forum	A0H GXD
Illich Iron & Steel	915 711
Khartszyk Pipe	A0B 5HA
Khmelnitskoblenergo	A0J DZG
LUASZ	A0J C2F
Marganetsky	A0B 8UA
Mariupol Heavy Machinery	A0F 63X
Naftokhimik Prykarpattya Refinery	A0J DZN
Nikopol Ferroalloy Plant	A0J DZP
Odeskable	A0J D0V
OJSC Sumy NVO Frunze	915 713
OJSC Zhydachiv Plup & Paper	916 337
Ordzhonikidzevsky Ore Mng&Pro	A0B 8UB
Poltava GOK GDR	916 338
Stankhanov Ferroalloy Plant	A0J D0W
STIROL	920 562
Sukha Balka	A0J D0Y
UKRNAFTA	920 564
Ukrtelecom	A0B 89V
Yasinovatsky Machine Building	A0J KHA
Zahidenergo	A0B 89U
Zaporizhzhya Ferro Alloy Plant	A0D 95K
Zaporozhstal Iron	916 339
Zaporozhtransformatior	A0J D01
Zytomyrgaz JSC	A0J D03

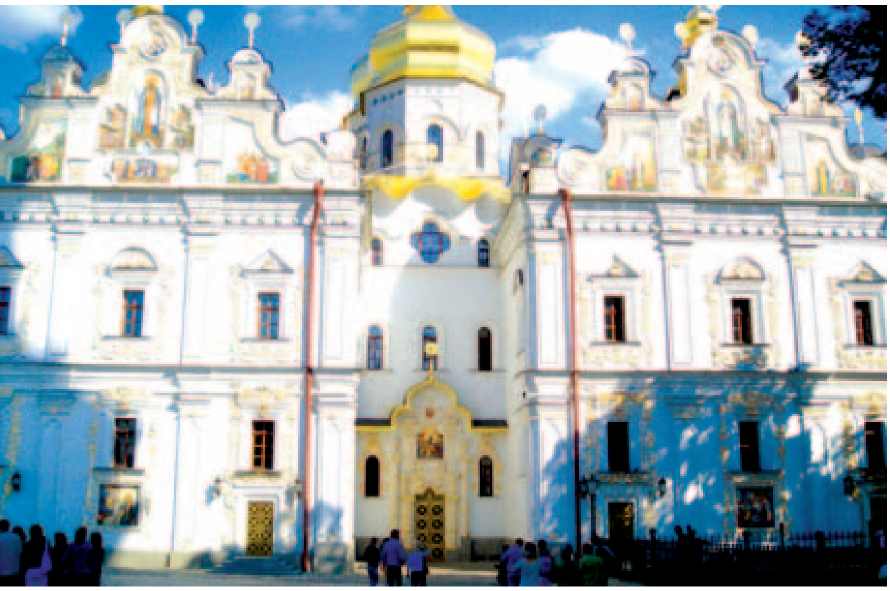
Seat of the ukrainian government (Source: The government of the ukraine); Ukraine has a strong industrial fundament; Pechers´k Lava

counted for 9,4%, excluding placements and illiquid stocks.

Reported trading volumes have been steadily growing, but most trading is still over the counter and unreported. One reason for the growth in volumes has been the development of the Frankfurt market, which has made Ukrainian stocks more accessible, especially to retail investors. Most of the more liquid companies on Ukraine's PFTS exchange have a secondary listing of depositary receipts (DRs) on the Deutsche Börse's Frankfurt exchange. We estimate total equity trading volumes of PFTS-listed stocks, excluding private placements, averaged around 200mln USD per month in August-October. About 80% of that trading was OTC, and only about 20% was made through the PFTS or Frankfurt exchanges.

Tab. 2: Top 5 companies	
by market cap. (USD mln)	
Ukrnafta	3.342
Ukrtelecom	3.271
Mittal Steel Kryvy Rig	3.095
Azovstal	2.021
Raiffeisen Bank Aval	1.983
by free float market cap. (USD mln)	
Nyzhnyodniprovsky Pipe	273
Ukrnafta	272
Ukrtelecom	238
Ukrsotsbank	148
Zakhidenergo	124

In recent months, banking and energy stocks have been by far the best performers. In August-October, bid prices for the two leading banking stocks – Ukrsotsbank and Bank Aval – gained 45,4% and 20%, respectively. Bid prices for the four state-owned thermal power generators, or GenCos – Centrenergo, Dniproenergo, Donbasenergo and Zakhidenergo – gained between 25% and 48%. The PFTS index gained 9,9% during the three-month period.



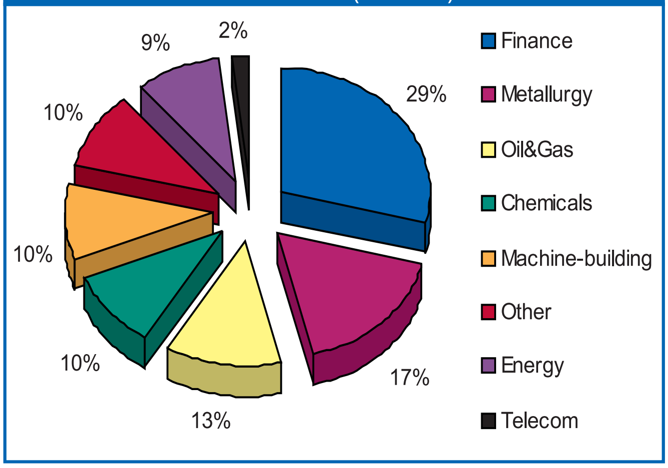
The banking sector is growing extraordinarily rapidly as products that were until recently rare in Ukraine, such as home mortgages and consumer credit, become part of the fabric of everyday life. The volume of consumer loans grew by an average annual rate (CAGR) of 102% in 2001-2005, and this year's growth is on course to reach around 110%.

Moreover, strategic acquisitions by major European banks have helped turn Bank Aval and Ukrsotsbank

into “blue chips”. Aval was bought last year by Austria’s Raiffeisen Bank, and Ukrsotsbank is being bought by Italy’s Banca Intesa. Ukrsotsbank was added to the PFTS index only in September, and it is already the third-most traded stock with a 9,7% weight in the index basket. Interest in Aval has increased recently as positive results of Raiffeisen’s clean-up work have begun to show up in Aval’s accounts.

The energy sector has been boosted by talk of possible privatization in the near future. The State Property Fund is proposing to reduce some state stakes in energy companies and sell off others, and a decision from the government is expected this month. There are also murmurs about a possible larger scale sell-off a year or two down the road, but no such official proposals. Even a mere reduction of state stakes would substantially boost the liquidity of energy stocks.

PFTS-TRADE VOLUME BY SECTORS (9M 2006)



Source: Concorde Capital

Transparency is key

In other sectors, recent performance has been more mixed. Notably, the two best performers in the metallurgy and mining sector were the companies that publish the most transparent accounts: Nyzhnyodniprovsky Pipe and Mittal Steel Kryvy Rig. Their bid prices gained 31,0% and 18,9%, respectively, in August-October. Poltava Iron Ore, by contrast, published less transparent accounts, and its bid price fell 12,0%. Although the general trend is towards greater transparency, there are big differences among the various companies in how quickly and consistently they are following the trend. Ukraine’s economy is growing rapidly thanks to solid global growth and high demand for steel, Ukraine’s main export. Real gross domestic product grew 8,9% year-on-year in September and by 6,2% year-on-year in January-September. Corporate net income was up 62,4% year-on-year in August in real terms, reflecting improved market conditions, greater transparency and increased efficiency. In the months ahead, investors will be looking very closely for signs of when US interest rates are likely to start coming down again, and whether the slowdown of US growth impacts on China’s growth. In any case, Ukraine will continue to be one of the region’s strongest long-term growth stories, with more opportunities to invest than ever.

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SHORTCUT-EXPLANATIONS

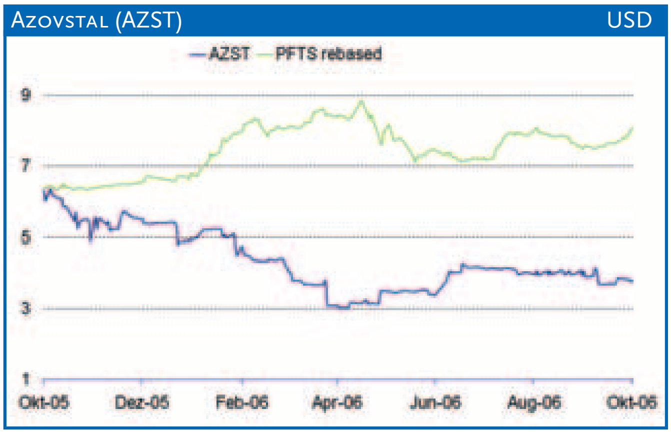
DR Ratio	deposit receipt ratio = the number of local shares representing one GDR
52 Wk H/L	High/Low past 52 weeks
Change YTD	stock price change from Jan 1st to today
Vol (FFM)	average trading volume per month in Frankfurt
Vol (PFTS)	average trading volume per month in Kiew
MCap, USD mln	Market Cap in Mio. USD
PFTS	the most well-known ukrainian stock market benchmark
P/E	Price-to-Earnings-Ratio
P/B	Price-to-Book-Value-Ratio
P/CF	Price-to-Cash-Flow-Ratio
USD ths	thousands USD
ths sq m	thousands of square meters

Azovstal

Ukraine's Steel Major

Profits from the strong world-wide steel demand

Business Profile
Azovstal is Ukraine's third largest steel maker after Mittal Steel Kryvy Rig and Mariupol Illicha steel mill. In august 2006, the company accounted for 15% of Ukraine's finished steel output with a production of 3,5 mln. Azovstal operates in-house blast furnaces (pig iron capacity of 6 mln mt per year), sintering facilities (1.5 mln mt of sinter per year) and steel smelting facilities. Azovstal's steel smelting includes three shops: a basic oxygen furnace shop (BOF, crude steel capacity of 4,5 mln annually), an open hearth shop (3 mln mt of crude steel annually) and an auxiliary electric steel smelting shop.



The company's production encompasses both flat and long steel products. It is a supplier of plates to Ukrainian and foreign shipyards and also sells high quality wide strip to producers of large diameter pipes in Ukraine (Khartsyzk Tube) and Russia (Vyksa Steel Works, Cheliabinsk Pipe Plant). Azovstal's long steel product range is represented by rails, bars, angles, profiles, etc.

Azovstal's controlling shareholder is System Capital Management (SCM), Ukraine's largest private corporation. SCM has a 12% share in the global billet market, a 10% share in the world slab market and a 9% share in the world strip market. SCM's owner (and Azovstal's beneficiary), Rinat Akhmetov, is allegedly Ukraine's richest person and has big political clout. He represents the ruling party, the Party of Regions, in the Ukrainian parliament, which ensures strong lobbying power for his business.

Recent Developments
Azovstal has seen positive developments in the last twelve months. At the end of 2005 the mill completed a merger with Ukraine's third largest coke producer, Markokhim, and is now self-sufficient in coke. In April 2006, the company successfully placed USD 175 mln in Eurobonds with yield at placement of 9,125%. The funds will be used to carry out modernization of the company's production facilities which will reduce natural gas use and improve overall efficiency. Specifically, by July 2007 Azovstal is planning to install a continuous casting machine with a capacity of 2,5 mln mt per year and a ladle-furnace.

Stock Market Prospects
Azovstal is a part of Metinvest Holding, the metals & mining arm of SCM. Metinvest is being prepared for an IPO on one of the western stock exchanges in 2007-2008. The IPO, if carried out, will likely be a trigger to the stock's price and bring an additional benefit to Azovstal's minority shareholders – enhancing transparency of the company's business.

On Oct. 21, 2006, Azovstal increased its charter fund by 54% thereby implementing the decision of its shareholders to merge with its trading house via a share swap. Earlier, on May 19, 2006 Azovstal's EGM approved the merger which put downward pressure on the stock's price. As no other dilutive share issues are anticipated in the future, the stock's price is expected to recover to USD 5,1 per DR (USD 0,51 per ordinary share).

After a doldrums season in May-July, trading in the stock on the PFTS resumed powerfully in August. September and October were marked with more moderate volumes, but the trend in volume size was upward. Trading in DRs on XETRA did not follow the dynamics observed on the PFTS and will probably lag behind the PFTS.

Andrey Gostik

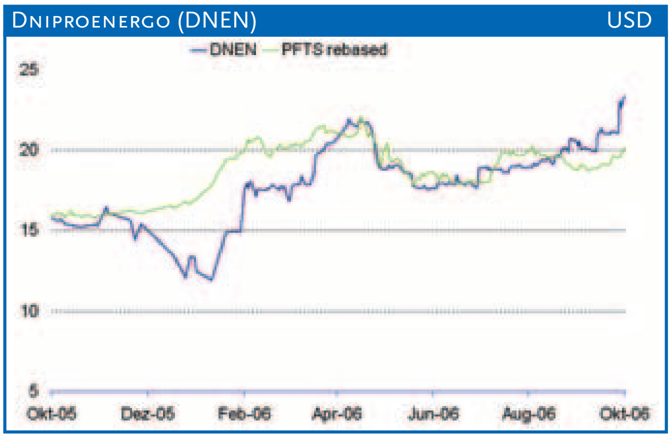
Azovstal

Ticker Xetra	DZ8 GR	Ticker PFTS	AZST		
DR Ratio	10	ISIN	US05480Q1004		
Market price, USD	**3,80**	**Market Multiples**			
52 Wk H/L, USD	6,7/2,9		2005	2006e	2007e
Change YTD	-41,5%	EV/Sales	0,7	0,9	0,8
Vol (FFM), USD ths	35,5	EV/EBITDA	4,7	8,5	6,7
Vol (PFTS), USD ths	776,0	P/E	8,1	10,0	8,5
		P/B	1,5	1,3	1,2
MCap, USD mln	**2136,3**	P/CF	6,9	7,7	6,8
Free float, %	4,0%				
FF MCap, USD mln	85,5	**Key Ratios**			
			2005	2006e	2007e
No. of shares, mln	**5.621,8**	Sales (USD mln)	2417,2	2220,5	2398,1
		EBITDA margin	15,6%	10,2%	12,0%
Stock Ownership		Net Margin	9,4%	8,2%	9,0%
SCM	96%	ROE	27,7%	15,4%	15,8%
Other	4%	Net Debt/Equity	-0,1	0,1	0,1

Dniproenergo

One of the Largest Power Generators

Dniproenergo was created in 1995 to operate three thermal power pants located close to industrial centers of Dnipropetrovsk and Zaporizhzhia regions. It is the largest Ukrainian coal-fueled thermal generation company by installed capacity (5,76 GW). Despite high demand for electricity in the regions close to Dniproenergo power plants, competition among generation companies is also high (there is also one nuclear power plant and two large hydroelectric power plants nearby). Nuclear and hydroelectry power plants supply cheaper electricity, so Dniproenergos' power has not been in high demand, which has resulted in poor load capacity. With the sharp increase in gas prices since Jan. 2006, the company decreased its share of gas in its fuel from 20% to 10% in the first half of the year, thus making its output less sensitive to gas price in Ukraine.



New Opportunities from Abroad

Recently Russia expressed interest in supplying its gas for gas-fueled Ukrainian power units to feed a capacity deficit, which currently exists in Russia, and opening a new opportunity for Dniproenergo. Dniproenergo will be able to start operations on some of its three gas power units (total capacity 2,4 GW) that have remained shut down as they were not price-competitive in recent years.

Dniproenergo					
Ticker Xetra	DPG GR	Ticker PFTS	DNEN		
DR Ratio	10	ISIN			US25600P1057
Market price, USD	**24,19**	**Market Multiples**			
52 Wk H/L, USD	25,4/12,0		2005	2006e	2007e
Change YTD	63,9%				
Vol (FFM), USD ths	16,0	EV/Sales	0,8	0,6	0,5
Vol (PFTS), USD ths	2462,3	EV/EBITDA	6,0	8,0	7,2
		P/E	71,1	40,3	22,7
MCap, USD mln	**379,7**	P/B	4,9	3,7	3,2
Free float, %	16,2%	P/CF	7,9	8,4	7,2
FF MCap, USD mln	61,5				
		Key Ratios			
No. of shares, mln	**3,9**		2005	2006e	2007e
Stock Ownership		Sales (USD mln)	408,0	585,3	674,0
NC ECU (state)	76%	EBITDA margin	16,1%	8,5%	8,9%
Alfa Capital	9%	Net Margin	1,2%	1,4%	2,2%
Other	15%	ROE	8,0%	12,1%	16,4%

Ukraine is "powered" by Dniproenergo

Time for Ukraine to Pay Dniproenergo Back for Financing the Ukrainian Economy

It is no secret that the Ukrainian economy survived hard times due to "debt financing" from the energy sector: most enterprises refused to pay for energy when they experienced financial problems, which allowed them to save working capital. As a result, consumers accumulated huge debts to Dniproenergo and the company accumulated huge debts to coal suppliers. Now, the company has a good chance to clear its debt accounts based on a new law, which gives the right to mutually write off the debts. Last quarter Dniproenergo's debt decreased 70 Mio. EUR. Dniproenergo will finance their modernization programs via additional surcharges to electricity tariffs from consumers, which will cover up to 80% of its reconstruction plan by 2010.

Privatization to Continue

Dniproenergo's stock is traded quite actively on the PFTS trading system, while Xetra trading remains insignificant (only a handful of deals every month). 15% of the company's shares are traded on stock exchanges while 76% are owned by state. Recently, the State Property Fund of Ukraine prepared a draft decree to continue the privatization of Dniproenergo. We expect 16% of the company to be sold on stock exchanges in 2007, which will increase the stock's liquidity and can become a booster for the stock price. We also expect the state to sell its remaining 60% stake in 2008-2009 to a strategic investor, which will speed up the modernization process and efficiency of the company. Since the company has been recovering financially during the last couple of years, the stock remains under-valued compared to other Ukrainian energy companies, trading currently at discounts of 55%-75% compared with Russian wholesale generation companies. The stock has risen 60% ytd and we see a potential upside of another 30%.

Alexandr Paraschiy

Nyzhnyodniprovsky Pipe

Ukraine's Largest Pipe Maker

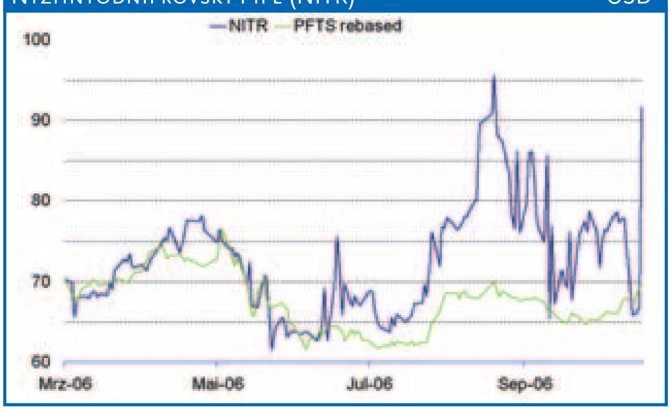
The pipeline demand is rapidly growing

Nyzhnyodniprovsky Pipe Rolling plant (NPR) is Ukraine's largest pipe producer. With an output of 439,1 ths mt of steel pipes in the first nine months of 2006, it claimed a 23% share in Ukraine's pipe production. The company has vast room for growing production, as its pipe making capacity exceeds 900 ths mt per year. Most of NPR's pipes are seamless (96% of total output in 2005), with OCTG being the core product. In addition to pipe production, NPR also makes railway wheels and tyres. NPR claims an 11% share in the global railway wheels market and is the largest global exporter of this product.

Duties Unable To Prevent Double-Digit Growth

It appears that NPR managed to successfully adapt to the EU's additional restrictions on Ukrainian seamless pipe imports in the second half of 2006. NPR's production numbers for the third quarter 2006 actually suggest that it was only slightly affected by the shrinking European market thanks to timely diversification into the Middle Eastern, Central Asian and CIS markets.

Nyzhnyodniprovsky Pipe (NITR) USD



Wheel Segment Expanding

The railroad wheels & tyres business currently generates ~45% of NPR's reported revenue. In September 2006 NPR began cooperation with the world's leading railcar maker, Bombardier, a landmark event for the company. NPR's management expects to receive 5 to 10 Mio. EUR from the contracts with Bombardier in the next 1,5 years, while the company's sales to Bombardier may reach 25 Mio. EUR. NPR also concluded a framework agreement with German Railways that will bring in 5 Mio. EUR within the next three years. In 2006, NPR expects to export 70 Mio. USD worth of wheels to countries outside the CIS (~10% of 2006e total revenue, by our estimates), while in 2007 exports to non-CIS regions might bring in total 100 Mio. USD (~12% of 2007e total sales). The expansion will reduce the company's dependency on CIS markets, and at the same time, NPR will maintain its dominant position on the domestic market.

Significant Progress in Fostering Transparency

Based on NPR's reported 2005 and interim 2006 financials, the company improved its financial reporting standards. There is evidence that NPR's holding corporation, Interpipe, has refrained from using NPR as a special purpose entity, which reduces the risk of unexpected cash drain and makes its cash flows more predictable. In addition to improved financial disclosure, the pipe maker surprised investors with record high dividends for 2005. The dividends of 196 Mio. USD were 80% higher than NPR's net income in 2005 and translated into DPS of USD 3,64, with a dividend yield of 27% at the date of announcement.

Nyzhnyodniprovsky Pipe					
Ticker Xetra	NYZ GR	Ticker PFTS	NITR		
DR Ratio	6	ISIN	US65486R1068		
Market price, USD	**82,80**	**Market Multiples**			
52 Wk H/L, USD	109,9/60,9		2005	2006e	2007e
Change YTD	17,0%	EV/Sales	1,1	0,8	0,9
Vol (FFM), USD ths	133,3	EV/EBITDA	5,2	3,2	3,4
Vol (PFTS), USD ths	1562,7	P/E	6,8	5,6	5,8
		P/B	2,4	1,7	1,3
MCap, USD mln	**743,6**	P/CF	6,4	5,2	0,0
Free float, %	9,3%				
FF MCap, USD mln	69,2				
		Key Ratios			
No. of shares, mln	**53,9**		2005	2006e	2007e
		Sales (USD mln)	622,8	735,5	763,0
Stock Ownership		EBITDA margin	20,0%	26,2%	25,2%
Interpipe	86,9%	Net Margin	16,6%	17,3%	16,0%
Management	3,8%	ROE	55,7%	42,4%	28,6%
Other	9,3%	Net Debt/Equity	-0,2	-0,2	-0,1

Stock Market Prospects

NPR is controlled by Interpipe, which is likely to go public in 2008-2009, just like Russian TMK did in November 2006. Trading in NPR's stock was relatively stable during the last twelve months both on the PFTS and XETRA, but September and October saw volumes declining, which apparently indicates a lack of sellers. Despite impressive price performance in 2006 (up 67% YTD), the stock still appears largely undervalued. NITR trades at discounts ranging from 19% to 50% on forward-looking EV/S, EV/EBITDA and P/E multiples to its peers in developed markets and at discounts from 1% to 21% on EV/EBITDA and P/E metrics to its GEM peers. Our target of 18 USD implies a 25% upside.

Andrey Gostik

Ukrnafta

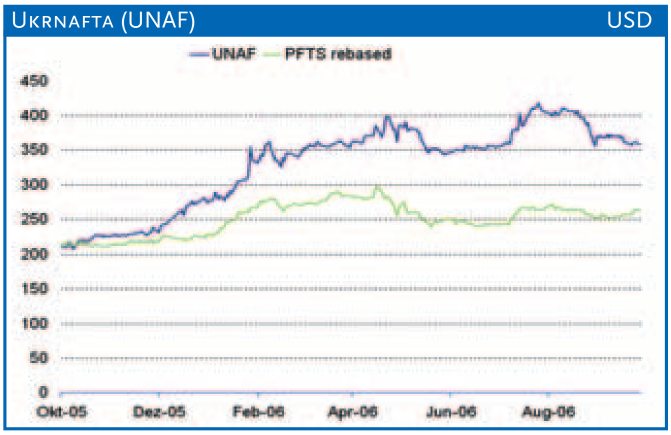
Ukraine's Largest Domestic Oil Extractor

The company is possessing huge hydrocarbon reserves

Ukrnafta is Ukraine's quasi-monopoly oil extractor and second largest gas extractor. The company is also involved in gas processing and is intensively expanding its retail trade of light oil products.

Large in Ukraine, Small in the World

The company's estimated total proved hydrocarbon reserves currently exceed 700 Mio. Barrel, according to SPE classification. Ukrnafta produces about 24 Mio. Barrel of crude and 21 Mio. Barrel of natural gas annually, accounting for over 86% of oil and 16% of gas extracted in Ukraine. The country is highly dependent on imported hydrocarbons and Ukrnafta is well positioned as the largest domestic oil operator.



Virtually all of Ukrnafta's oil is processed domestically at the UkrTatnafta refinery and two refineries affiliated with the Privat group, a Ukrnafta shareholder. Currently, oil products processed at these refineries from Ukrnafta's crude barely cover its retail segment needs as high-octane products are mostly imported. We expect the company to intensify fuel purchases as its retail segment continues to grow.

Penetration Into the Retail Market

Ukrnafta began to acquire gas stations in 2003 and currently owns the largest fuel retail network in Ukraine with over 500 outlets, and about a 12-14% share in domestic retail fuel market. The share of retail fuel sales in Ukrnafta's gross sales is expected to increase from the current ~40% to 65% in 2010. The company does not possess in-house oil refining capacities and has to outsource oil processing to domestic refineries.

As the development of Ukrnafta's upstream segment is dependent on its extraction projects off-shore (in Nigeria, Libya, Central Asia), expansion of the company's retail business is going to be the key growth driver in the next 5-10 years. However, rapid expansion in retail pushes the company's margins down.

Powerful Local Blue Chip

Ukrnafta's stock is one of the most actively traded local blue chips and is widely perceived as a proxy for the Ukrainian market. Most of trades are still OTC. The stock's monthly average exchange trade exceeds 8 Mio. USD, with around 80% of trades done via the PFTS. The remaining 20% of deals are settled through the Xetra trading floor.

No Upside Seen Currently

Since 2004 Ukrnafta's stock has significantly outpaced the growth of its peers – the stock's price growth rate was 4,5 times higher than its peers and 8,5 times higher than Urals. Until 2006, Ukrnafta's growth was driven mainly by a catch-up effect to international peers. Although the gap was closed in the first half of 2006, the stock price jumped by 14% in August on the back of Ukrnafta's nice-looking first half results and expectations of greater political stability, not to mention the lack of reasonable alternatives in the Ukrainian stock market.

It appears that Ukrnafta has exhausted its catch-up potential and the fundamentals suggest that its stock is expensive compared to its peers. Notwithstanding better than expected first half results of 2006 and high fuel and hydrocarbons prices, the company's value is going to be hurt by a series of increases in royalties and lagging fuel sales from its newly acquired gasoline stations.

Vladimir Nesterenko

Ukrnafta

Ticker Xetra	UKAA GR	Ticker PFTS	UNAF		
DR Ratio	6	ISIN	US9037272047		
Market price, USD	**364,80**	**Market Multiples**			
52 Wk H/L, USD	410,0/206,5		2005	2006e	2007e
Change YTD	51,3%				
Vol (FFM), USD ths	2999,7	EV/Sales	3,1	2,0	1,7
Vol (PFTS), USD ths	8913,4	EV/EBITDA	5,7	4,8	5,7
		P/E	9,0	7,6	9,5
MCap, USD mln	**3297,1**	P/B	3,2	2,8	2,5
Free float, %	8,0%	P/CF	7,1	5,9	6,6
FF MCap, USD mln	263,8				
		Key Ratios			
No. of shares, mln	**54,2**		2005	2006e	2007e
Stock Ownership		Sales (USD mln)	1087,9	1701,9	2052,6
Privat Group	42%	EBITDA margin	53,9%	41,4%	30,3%
Naftogas Ukrainy	50%+1	Net Margin	33,5%	25,3%	16,8%
Other	8%	ROE	37,2%	41,8%	28,9%

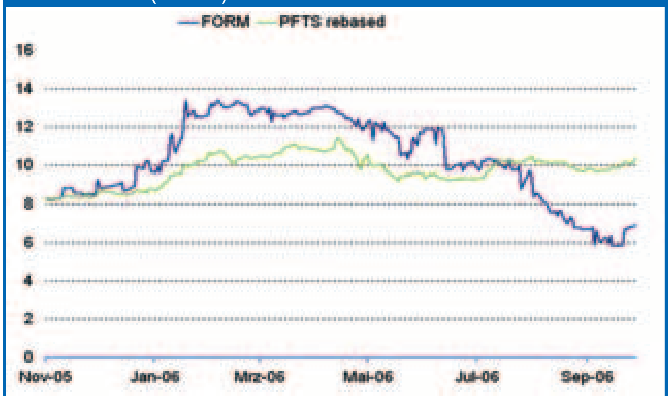
Bank Forum

Aggressive Expansion into Retail

Bank Forum is headquartered in Kiev

Bank Forum is Ukraine's 13th largest bank, with 994 USD mln in assets at the end of the first half of 2006. Founded in 1994, Forum is a universal financial institution offering corporate, retail, treasury, and investment banking services to over 7.300 corporate and 56.000 private customers. Since 2001 assets and customer loans in the Ukrainian banking sector have increased by 447% and 571% respectively, whereas Forum's assets and customer loan portfolio grew 14,5 and 15,7 times respectively. As of July 1, 2006, Bank Forum, with 712 USD mln in loans, was the country's 11th biggest lender. The bank is primarily focused on corporate business though loans to private customers surged 104 times since 2001. The bank's 146 branch offices and network of 158 ATMs ensures nationwide coverage. Bank Forum is the only Ukrainian banking stock listed on the Frankfurt stock exchange.

Bank Forum (FORM) USD



Robust Growth

In the last few years, Bank Forum's growth rates have outpaced the whole banking sector. Total assets, customer loans and deposit growth were 81%, 79% and 88% CAGR respectively for 2002-05, two times higher than the sector average for the period. The solid growth pace allowed the bank to expand its market share in assets from 0,76% in 2002 to 2% as of July 1, 2006, which increased its share in total lending from 0,76% in 2002 to 2% in the first half of 2006.

Aggressively Expanding into Retail

The bank's management has been putting greater emphasis on the expansion into the promising retail sector. Forum's loans to private customers increased 104 times since 2001, and brought the retail portion of the bank's total loan portfolio from 2,2% in 2001 to 16,2% in the first half of 2006. Forum has been aggressively expanding its retail network and has already doubled the number of branches to 146 since the beginning of the year, and plans to have a network of 300 branches by 2008.

Exposure to Cheaper Borrowings

To improve its liability structure, the bank has increased its efforts to raise foreign debts via syndicated loans, Eurobond placements and EBRD lending programs. In 2005, the share of foreign borrowing in the bank's liabilities grew to 8% from 2% in 2004, replacing more expensive domestic debts.

Buy Fair + Subscribe Cheap

To sustain a growth rate double that of the market, the bank, in July 2006, increased its share capital by 68% through a 50 USD mln additional share issue to 123 USD mln. A prior 37% additional issue, in the late 2005, was connected to the private placement of a 10% block to portfolio investors according to the formula "Buy Fair + Subscribe Cheap." Investors that participated in the equity placement subscribed for cheap shares (priced at par value, far below the market) on a pro rata basis and automatically received a lower P/B, which effectively reduced the average cost of their shares. The recent issues are unlikely to be the last ones, as rapid balance sheet expansion will require another ~50% share capital increase in 2007, offering an opportunity for shareholders to further reduce the average cost of their investments in the stock.

Cheap, for Now

The two share issues in the past eleven months made Forum Ukraine's cheapest banking stock. Based on 2006E P/B multiple, Forum has a 40% discount to its Ukrainian peers and 20% compared to the CEE peer group.

Alexandr Viktorov

Bank Forum

Ticker Xetra	B5F GR	Ticker PFTS	FORM		
DR Ratio	1	ISIN	US3498091038		
Market price, USD	**6,40**	**Market Multiples**			
52 Wk H/L, USD	76,2/6,0		2005	2006e	2007e
Change YTD	-28,6%				
Vol (FFM), USD ths	37,0	P/E	70,5	59,7	32,8
Vol (PFTS), USD ths	387,8	P/B	5,2	2,4	1,9
		P/Loans	0,9	0,5	0,3
MCap, USD mln	**396,8**	P/Deposits	0,9	0,6	0,5
Free float, %	10,0%				
FF MCap, USD mln	39,7	**Key Ratios**			
			2005	2006e	2007e
No. of shares, mln	**62,0**				
Stock Ownership		Assets (USD mln)	730,2	1204,8	1743,1
Provita Co	65%	Net Interest Margin	5,80%	6,00%	6,90%
Elmak Co	15%	Net Income Margin	11,90%	10,80%	11,80%
Global Portfolio Fund	10%	ROE	9,2	5,5	6,5
Other	10%	Cost/Income	58,80%	61,90%	63,20%

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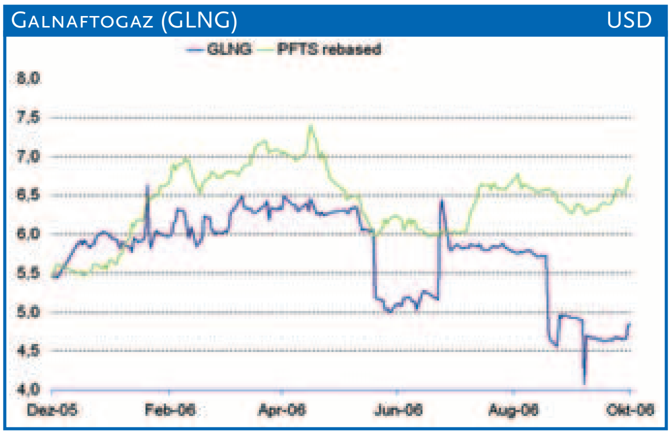
SI 12/06

Galnaftogaz

Ukraine's Fast Growing Fuel Retailer

Galnaftogaz is building up a chain of fuel service stations

Galnaftogaz is Ukraine's largest non-integrated fuel retailer and only public oil product distributor. The company derives its value from exceptional growth of its business, diversification into convenience goods and services, exemplary corporate governance and efficient cooperation with international finance institutions. The company has a western-minded management team and embarked on a strategy to create a chain of European-style service stations. An IPO is planned for 2008. Independence from major business groups, coupled with western management style, ensures the company's enhanced transparency and corporate governance. Galnaftogaz is one of the most investor-friendly companies in Ukraine, closely cooperating with top local and foreign investment banks. The company's public debt is among Ukraine's most liquid corporate bonds.



Retail Network Continues Expansion

Galnaftogaz operates a network of total 205 gas stations, making it the Ukraine's fifth largest gasoline retailer chain. Galnaftogaz emerged from western Ukraine and is a regional market leader, but also has aggressively penetrated into eastern and central regions. The company has developed its own brand, OKKO, and increased the number of branded stations more than five times since 2001. The company's OKKO brand is well-recognized in Ukraine for both fuel and service quality and currently has 155 stations. With a 6% share of the Ukrainian oil product market, Galnaftogaz ranks fourth in terms of volume sold and leads the market in daily fuel sales per station, together with LUKOil and TNK-BP. Driven by rapidly growing consumer incomes, number of cars per capita, and increasing traffic mileage, the domestic gasoline market is poised to benefit from strong demand over the nearest years. The company plans to expand its retail network two times by 2010, with a goal of capturing a 8-11% share of the Ukrainian automobile fuel market.

Potential Risks: Oil Dependence & Government Regulations

Currently, Galnaftogaz purchases about 60% of its oil from two (of six) domestic refineries (Kremenchuk and Lisichansk) and imports the remainder from Lithuania (Zeikiu Nafta), Belarus (Mozyr refinery) and Russia (Samara refinery). Although the lack of its own refining capacity puts Galnaftogaz under the risk of squeezing retail markups, the cancellation of import duties in 2005 reduced the market power of domestic refineries, thereby securing reasonable markups in retail. Another threat is the government's efforts in regulating local fuel prices. However, the cabinet has agreed with both refineries and retailers to cap the prices at a level high enough to satisfy everyone.

Galnaftogaz

Ticker Xetra	C9Z GR	Ticker PFTS	GLNG		
DR Ratio	500	ISIN	US20601L1044		
Market price, USD	**4,50**	**Market Multiples**			
52 Wk H/L, USD	6,5/3,7		2005	2006e	2007e
Change YTD	-19,5%				
Vol (FFM), USD ths	4,8	EV/Sales	0,5	0,4	0,4
Vol (PFTS), USD ths	13,2	EV/EBITDA	10,2	8,0	5,9
		P/E	17,4	15,0	7,2
MCap, USD mln	**144,0**	P/B	2,2	1,8	1,5
Free float, %	23,0%	P/CF	10,8	8,7	4,5
FF MCap, USD mln	33,1				
		Key Ratios			
No. of shares, mln	**16.000,0**		2005	2006e	2007e
Stock Ownership		Sales (USD mln)	361,0	505,4	786,1
F.I.E.H.	73%	EBITDA margin	4,8%	5,5%	6,0%
Antonov Family	4%	Net Margin	2,0%	1,7%	2,3%
Other	23%	ROE	19,8%	14,5%	25,2%

Galnaftogaz, by the Numbers

Thanks to its rapid expansion pace, Galnaftogaz's sales grew by a remarkable 57,3% in 2005, to 380 Mio. USD. This year, we expect the company to post a 33,2% increase in its consolidated revenues, 75,2% higher EBITDA (28 Mio. USD) and a 18,6% increase in net income (to 9 Mio. USD). In the course of its two private placements during 2005-2006, the share of portfolio investors in Galnaftogaz's share capital has increased from 7% to 23%. Meanwhile, its stock price jumped by 47%, from the pre-placement level of 3,40 USD per a depository receipt to the current 5 USD/DR.

Vladimir Nesterenko

Dairy Sector

Plenty of promise, but still a few obstacles to overcome

The dairy sector is among the most important sectors in the Ukrainian food industry, e. g. Ukraine was ranked #3 exporter of hard cheeses in the world. Production of dairy products in Ukraine reached USD 1,32 bn in 2005, contributing 1,6% to GDP. We expect some Ukrainian dairy producers to make an IPO in the beginning of 2007.

Huge potential upside in consumption

With 48 mln people, Ukraine is the fifth largest European country in terms of population and represents an attractive market for dairy products. Ukrainian consumers loved dairy products during Soviet times as per capita consumption of dairy products reached 140 kg in late 1980s, but decreased in mid 1990s, as real personal income fell after the collapse of the Soviet Union. After the economy revived in late 1990s and real income grew by double-digit figures, per capita consumption of dairy products began to increase again, hitting 48 kg in 2005, which is still much lower than 110 kg in the EU-15. Particularly, per capita consumption of hard cheeses in Ukraine was 3,4 kg in 2005, compared with 19,1 kg in the EU-15, 14,4 kg in the USA and 9,9 kg in Canada.

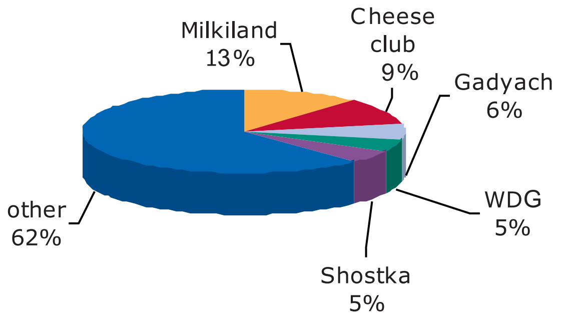
High vs. low value-added products

High value-added products accounted for 20% of the market in 2005 and are expected to outperform traditional dairy products in terms of growth. High value-added products include hard cheeses, butter, yogurts, ice cream, etc. as opposite to so-called traditional, low value-added dairy products, including milk, kefir etc

Competition

Currently, 550 companies are operating in the Ukrainian dairy industry. Most of the them are very small and 500 of them have sales less than USD 10 mln, operate obsolete production facilities and produce mostly traditional dairy products. As transportation of raw milk and traditional dairy products is not always economically beneficial, small companies maintain only local and regional operations, i. e. raw milk collection. Due to a lack of capital, small companies are non-competitive and are consistently run out of business due to pressure from large players.

LARGEST PRODUCERS OF HARD CHEESE IN UKRAINE



Source: State Committee of Statistics in Ukraine

M&A ACTIVITY OF FOREIGNERS IN UKRAINIAN DAIRY SECTOR

Ukrainian company	Acquired by	Year of acquisition	Sales*, $ mn.
Nikolaev milk plant	Lactalis (France)	1996	55,1
Kyiv City Dairy Plant	Wimm-Bill-Dann (Russia)	2000	47,6
Zvenigorodskiy cheese	Borgain (France)	2001	19,6
Kharkovsky dairy plant	Wimm-Bill-Dann (Russia)	2002	44,8
Galakton	Unimilk (Russia)	2004	48,5
Bilosvit	Lactalis (France)	2004	19,8
Rodich	Danone (France)	2006	12,6

(*) – in 2005
Source: State Committee of Statistics in Ukraine, Ukrainian News

The majority of the largest Ukrainian dairy producers grew through acquiring a number of the most attractive production facilities in Ukraine and upgrading existing facilities. So far, only a few large Greenfield projects were realized.

Competition occurs mostly between key players in high value-added products. Consolidation is still low, e. g. the five largest producers of hard cheeses held 38% of the subsegment.

Increasing interest among foreign strategic investors

Ukrainian producers of dairy products have been on the radar of foreign strategic investors since 1996. Penetration into the Ukrainian market was initiated by French producers, continued by Russian producers, and interest from foreign investors is still high, given the market potential.

Russian protectionism

Russia protected its domestic market, by restricting the import of dairy products from Ukraine in the beginning of 2006 due to concerns about low quality of products. Russia was an important market for Ukrainian producers while exports of dairy products to this country reached USD 0,37 bn in 2005. Only a few Ukrainian plants have received permission to export products to Russia following the inspection of their production facilities. Currently, Ukrainian producers are exploring new markets including other CIS countries, Asia and Africa.

MILK SUPPLY IN UKRAINE BY REGIONS

Source: State Committee of Statistics in Ukraine

Supply of raw materials
In 2005, individuals supplied 82% of raw milk while farms accounted for only 18% of the total supply.

The quality of the raw milk supplied by individuals is instable and inconsistent and thus, producers strive to establish close relationships with the suppliers of raw milk.

Yevgen Sysoyev

Milkiland Corporation

An IPO candidate

Milkiland Corporation has become a major player in Ukrainian dairy industry. It was founded in 1996 through a number of acquisitions and the expansion of existing production facilities. It operates 23 production plants in 8 out of 26 regions (oblasts) in Ukraine, mainly in North and West Ukraine.

The company has a diversified product portfolio of hard cheeses, butter, traditional dairy products, dry non-fat milk and ice cream. In 2005, it was the largest processor of raw milk in Ukraine, first in hard cheeses (12% of total production in Ukraine), among the top-5 in non-fat dry milk production (11%) and butter (7%). Milkiland products are well-known not only on the domestic market. Export sales accounted for 40% of sales, 78% and 9% of which were to Russia and Algeria respectively. The two largest cheese producing plants of Milkiland were inspected by the Russian Veterinary Agency and received permission to continue exports to Russia. In 2006, while continuing exports to Russia, Milkiland began exploring new export markets, e. g. Kazakhstan.

The company has production capacities to process up to 800.000 mt of raw milk and produce 69.000 mt of traditional dairy products, 36.000 mt of dry non-fat milk, 33.000 mt of cheese, 12.000 mt of butter.

Improving financial performance
According to financial statements prepared in accordance with IFRS, sales reached USD 172 mln in 2005, up by 120% yoy, with an EBITDA of USD 10,3 mln, implying an EBITDA margin of 6%. During 7M06, sales amounted to USD 82,3 mln with an EBITDA of USD 9,9 mln. Thus, the EBITDA margin has improved to 12%.

THE MAIN FOCUS OF MILKILAND'S PRODUCTION

Source: Company data

Future plans
Thanks to its favorable positioning in high value-added products, Milkiland's goal is to further expand its presence through both organic growth and acquisitions.

The Milkiland Corporation plans to make an IPO on the Frankfurt Stock Exchange in the first quarter of 2007, offering up to 20% of its share capital.

Yevgen Sysoyev

Real Estate and Development Sector

Offering high margins and growth potential

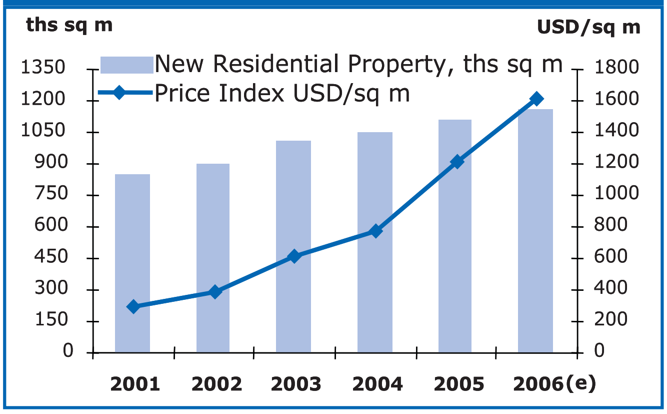
Real estate offers growth potential

Ukraine's property market is among the most dynamic in the world, growing at 30-35% CAGR. Its volume in 2005 approached USD 3 bln, more than USD 1 bln of which is from the Kiev real estate market alone. High yields in the construction sector result in rising housing volumes and intensifying activity in the residential, office, retail, and warehouse segments.

Residential Sector Is Starting to Grow

Over the last 5 years, the construction of residential properties in Kiev accelerated only slightly, but prices for residential property increased rapidly to record highs. In 2005, 1.107 ths square meters of residential space was built in Kiev, which is 5,4% more than in 2004 (1.054 ths sq m) and 4,9% more than in 2003 (1.050 ths sq m). There is currently just 18,5 sq m of residential property per city resident in Kiev. We forecast an increase to 35 sq m per person in ten years.

Fig. 1: Amount of New Residential Property and Price Index



Source: State Statistics Committee of Ukraine

Offices: Demand Strong, Supply Lagging

Demand for good quality office space continues to be strong. The vacancy rate is expected to fall further from 4% last year to just 3% in 2006. Demand for large office space is mainly coming from foreign companies, although the share of Ukrainian companies has also been increasing.

Compared with other cities in Central Europe, Kiev has a significantly smaller amount of commercial real estate. The total area of offices in Kiev as of 1H06 was 507 ths sq m compared with Moscow and Warsaw (1.400 ths sq m and 1.800 ths sq m respectively).

Yields Are High But Falling Gradually

Kiev's market also has substantially lower yields compared with Western and Central Europe. Vendors of quality offices are offering their property for an average yield of 10-16%. The trend is headed downward, but it is moving gradually. This follows the trend in the rest of Central & Eastern Europe and Russia, which are a few years ahead of Ukraine in terms of real estate development.

Fig. 2: Kiev Offices, 2001-2006

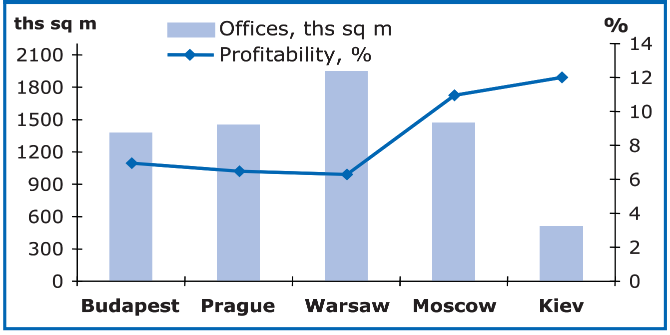
	2001	2002	2003	2004	2005	2006 (e)
Total volume (ths sq m)	156.2	173.9	246.7	356.7	506.7	676.0
New annual construction (ths sq m)	4.2	17.7	72.8	110.0	150.0	170.0
Lease property (ths sq m)	22.5	18.0	50.7	55.0	92.0	100.0
Annual rent rate (class A), USD/sq m	250.0	250.0	324.0	336.0	408.0	480.0
Profitability of office premises, %	22.0	19.0	16.0	14.0	12.5	12.0
Vacancy rate (%)	15.0	4.0	8.0	5.0	4.0	3.0

Source: DTZ, Colliers International

Retail Space Is Also Limited

Despite continued growth of Ukraine's organized retail (up 20% annually), record breaking GDP growth and increasing real wages over the past several years, the Ukrainian retail market remains massively undersupplied with quality retail space. In Kiev, there is only 95 sq m of retail space per 1.000 residents, compared to 185 sq m in Moscow and 359 sq m in Warsaw. Currently, the total retail space in multi-tenanted retail centers is at about 320 ths sq m, which is comparable to the Warsaw retail market in 1998. With around 1.000 ths sq m of retail space being currently in the pipeline, retail space is supposed to grow by up to 50-70% annually in the next few years.

Fig. 3: Offices in Central & Eastern Europe, total area and profitability as at 1H06



Source: State Statistics Committee of Ukraine

There Is Still Room for New Players

The lack of high-quality real estate property and high margins in the sector have allowed for new players to enter the market. The number of construction and development companies (currently 115) has increased steadily. The leading companies are Kyivmiskbud, TMM Group, Zhitlo-Invest, Kiev-Donbass, XXI Century and Poznyakizhilstroy.

Prospects for the Market

There are many economic and political factors that make the construction and development sector in Ukraine a great opportunity in the near future.

- There is a severe shortage of residential, office, warehouse, and retail space;
- Yields are high compared to the rest of Europe;
- The new government is introducing pro-business reforms and foreign direct investment is growing rapidly;
- Consumer purchasing power is rising significantly;
- Credit markets are developing quickly and financing costs are dropping.

Havrilenko Dmitriy, Yevgen Sysoyev

TMM Group

An IPO candidate

With net sales of USD 53 mln in 2005 and its own construction capacities, the TMM Group is among TOP-5 constructors in Ukraine.

Profile

The company was founded in 1992 and manages a diversified portfolio of real estate assets, comprised of high-end deluxe residential complexes and commercial properties. The company's projects are predominantly in Ukraine's capital, Kiev, as well as other densely populated regions of Ukraine (Kharkiv, Zhitomir and Yalta).

The Ukrainian real estate sector stands clear for growth.

Solid Portfolio

TMM currently has one of the largest portfolios of real estate assets in Kiev. The company has two services: residential real estate projects and the construction of offices. However, it is planning to enter the commercial real estate market. Over the last seven years, TMM Group has constructed about 223 ths sq m of property (residential space and offices) and about 543 ths sq m are currently under construction. Projects under development account for an additional 687 ths sq m. All necessary permits and approvals to implement projects, which are under construction, have already been received.

In 2007-2008, TMM plans to construct new residential complexes with a total area of 191 ths sq m.

Since the strong demand for high-end residential housing and office property in Kiev will remain largely unsatisfied through 2007-2009, the company's financial performance is expected to improve significantly.

Future Plans

TMM Group plans to make an IPO on Frankfurter Stock Exchange by the end of February 2007 by offering up to 10% of its share capital. The proceeds from the IPO will help to acquire real estate for future projects and to develop new projects on the real estate market.

Havrilenko Dmitriy, Yevgen Sysoyev

I was already invested two years before the "Orange Revolution"

Smart Investor in an interview with Stefan Laxhuber, expert investor for Eastern Europe and derivatives advisor about the political argy-bargy in the Ukraine, the Russian influence on the country and the strength of the Ukrainian economy

Smart Investor: Mr. Laxhuber please tell me how you discovered a market like the Ukraine?
Stefan Laxhuber: First of all part of my job was to make business in Eastern Europe including travelling a lot in this area and establishing subsidiaries for my employer. 1998 – in the year of the Russian Crisis – I spotted the possibility to buy assets there for really cheap prices. You could for instance watch how the Baltic countries, which heavily suffered from the Russian Crisis, suddenly dynamically recovered. This was a hot potatoe at that time. Mutual funds which were invested in Eastern Europe at that time all had suffered badly. German or English research was not available at all. And that is how I got involved into these markets – first part-time and then on a regular base.

Smart Investor: Could you just roughly describe your investment approach?
Laxhuber: I would be exaggerating to compare my approach with the value strategy of Warren Buffett. But conceptionally it goes along those lines. I usually do not invest in companies that only have a growth story to offer. I am a value investor strongly based on fundamentals. You always got to be aware of the intrinsic risks. In Eastern Europe these are usually political risks in combination with the fundamentals and valuation ratios. Especially the data of the not so well known markets in Eastern Europe are simply unbeatable.

Smart Investor: You are known as somebody to be the very first in certain Emerging Markets. What about the Ukraine? Are you invested there at the moment? Do you currently increase your investments or do you reduce them?


Laxhuber is still a first mover in eastern european stock markets


Stefan Laxhuber

Laxhuber: Good question. I am invested there since longer. We got in there two years before the Orange Revolution. Six or seven months ago we reduced some investments while others were increased. We redeployed capital within the Ukrainian segment. Now we are about to add on some positions, because we regard the Ukraine as a promising market. Although I want point out the long term perspective, on the short term I am a little bit more sceptical.

Smart Investor: What are the reasons for your scepticism?
Laxhuber: Surely the political argy-bargy. But I do not tell you anything new. We have had problems in the past 12 months, past 12 weeks and past 12 days. This can scare off potential investors. On the other hand: I have just read a correct statement on Ukrainian stock market. "Ukraine is a bullet-proofed market." Freely translated: The market has been recently bombed out. But it recovered very well. I like this, because it means that an array of bad news is already priced in. It cannot deteriorate much more. On the contrary, investors for example are still not aware of the first positive legislative steps which have taken place in favour of the stock markets. According to Kostolany – that is just the right time to enter the market, although there might be some setbacks you have to sustain for a while. In the moment I would not regard the Ukraine as a trend market. On the short term I still expect a rebound.

Smart Investor: What could cause a rebound?
Laxhuber: Politics! Just to show a good example – the prime minister Yanukovich palms himself off as a populist. In this part he made sure that the electricity and gas prices for private households were reduced by 20%. But in reality energy has not become cheaper. So finally somebody has to pay for it – maybe

Laxhuber visited the Ukraine a lot of times – and hit on some interesting investments

the industrial sector. For instance the energy-related sector may be suffering. On the mid term this is counter productive for the economy, but on the other hand it delivers more near-term votes – i. e. a political success. This is only one of a lot of examples.

Smart Investor: Why is Russia threatening to reduce the shipment of gas to the Ukraine?
Laxhuber: There was a to and fro between the two countries. Russia has been brutally increasing the gas prices for its former satellite states to world market levels. Unfortunately the Ukraine was totally struck.

Smart Investor: Maybe Russia's real intend is to stop the democratic revolution?
Laxhuber: I see this dangerous possibility in the Eastern Ukraine, because the country is still divided in two parts. While the Western Ukraine is clearly focused on the Western World, the East of the country is definitely still influenced by Russia. This could cause more tensions. Also speculations continue on whether the country may divide in the future. I don't think it's realistic, but politics in this country will be blocked from this issue for a while. In the moment you cannot take the Ukraine for an exemplar for reforms. I also have to state, that the developments up to now have considerably undermined the confidence of the economy – but not so much of the population. This of course makes it difficult to execute radical reforms.

Smart Investor: Recently the economy came heavily under pressure?
Laxhuber: That is right. 2004 the economy was growing at 12% a year – a year later only at 2,6%. For the first six months of this year the growth rate is up to an official estimate of 5,5%. For the whole year the estimations are at 6,6% growth rate. I myself think it will range at least around 7%.

Smart Investor: Where do you see the strength of the Ukrainian economy?

Laxhuber: You mean, where I would invest now. And I must state: consumption, consumption and consumption again! Just look at the boom in the consumer sector in Russia. There is a real shift from the cheap to the luxury segment. You can see it at the revenue per square meter. In our certificate we are heavily invested in retail, partly in private equity. One of them, the Retail Group Velyka Kyshenya, will float at the London Stock exchange in 2007. That is happening in the background of strongly growing personal income. Inflation and tax adjusted they grew at 19% in the first nine months of 2006 – notably without the money which has been paid outside of the statistics. That is why the profits of the retail companies are virtually exploding. There we overweigh this sector heavily.

Smart Investor: Which other sectors do you like?
Laxhuber: Producers of coke are very interesting. Neither China nor India have sufficient coke. In order to produce steel they have to import this commodity. The Ukraine has huge resources of coal and has many coke producing companies. However, none of them is listed at the German stock exchange. I also see promising producers of pipelines, for example Nizhnodniprovsk Pipe Rolling Works (NPR) or Dnipropetrovsk Tube Works. As to oil it looks like that the Ukraine – the company Ukrnafta – has resources, but not enough for exports to the world markets. Ukrnafta is indeed 50% dominated by the state but by far not valuated at the fair price. However, the state might retreat only at significantly higher prices. For a major rise in the price the company needs restructuring by the state. Only then they will achieve a higher price.

Habour of Tallinn – Estland was one of the first picks in eastern europe of Stefan Laxhuber

Smart Investor: Which would be your three standard investments?
Laxhuber: Ukrnafta is a long term investment – also the already mentioned NPR or the two electricity companies Dniproenergo and Centrenergo.

Smart Investor: In which country do you invest besides the Ukraine?
Laxhuber: We are well invested in Georgia. But the market has already rallied pretty well. Usbekistan with 26 million inhabitants, a well working agriculture, and its resources of oil and gas is also very promising. There is a political risk, because the country lacks high foreign estimation. But because of the political tensions, people don't wait and are simply entrepreneurial. I like that. We have also funds in Armenia and Moldavia, but the markets there are more illiquid.

Smart Investor: Where will be the Ukraine in five years?
Laxhuber: Western Ukraine belongs to Europe – there is no doubt about it. But it will be critical what will happen in the East of the Ukraine. If the Western world fails to integrate the East, then they might actually separate. Therefore we invest in companies having their business mainly in Western Ukraine.

Smart Investor: Thank you very much for the interview.

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