

Ukraine's TOP 10 Shares to Buy in 2009

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Some competent US magazines including Forbes and Smartmoney have proposed quite recently their lists of the most prospective shares for 2009. To our great surprise, the lists include, among others, shares of fertilizer producers (share prices of which declined by 70%), and also shares of some financial companies.

TASK Group proposes its own version of the most prospective shares listed in the Ukrainian stock exchange – the PFTS. We outlined TOP-10 shares of Ukrainian enterprises.

Our research is based on current economic conditions that have a direct impact on companies' activities. Synthesis of parameters gives evidence that the most prospective shares must include shares of enterprises the production of which is in high demand despite difficult economic conditions.

As a rule, such shares have a low beta ratio. Thus, under the conditions of socio-economic and political instability the enterprises that satisfy primary needs of population are less risky. At the same time, we can not exclude other issuers, for example, important exporters that produce standardized products using domestic raw materials. Competitiveness of the export-oriented enterprises will increase simultaneously with devaluation of the Ukrainian currency; and the probability of further devaluation is rather high in the first half of 2009.

Enterprises below are ranked by their investment attractiveness. We enumerate shares that merit investors' attention.

Our calculations were made on March 24, 2009 and are based on information from publicly available sources.

The target price is the result of deep analysis, which was arrived at by using DCF, comparative and hang-the-expense approaches. The target price of export-oriented enterprises is elastic to changes in the exchange rate. The exchange rate used for calculations was the official rate on the date of writing the article.

1. Zakhidenergo (ZAEN) is a power station, which possesses 9% of all Ukrainian power generation capacities. The enterprise's location close to a large electricity consumer – the European Union – creates favourable conditions for a long-term growth. The Burshtinskaja Thermal Power Plant, which is a separate unit within Zakhidenergo, is a tie-up with the Union for Co-ordination of Transmission of Electricity (UCTE). This is why it has the opportunity to export electricity to Hungary, Slovakia and Romania. Despite its aged equipments, the station has good opportunities to increase its electricity production in the medium term. Moreover, Zakhidenergo can reduce costs through asset modernisation.

With regards to its shares, Zakhidenergo's stocks are highly liquid even in crisis. Moreover, the shares have the lowest volatility among all listed power stations' shares. Anticipated forward level of level of P/S ratio by the end of 2009 is 0.84, P/BV ratio – 2.7. **The target price is 45.84 \$ per share, which assumes 76% growth in 2009.**

2. Centrenergo (CEEN) is the biggest Thermal Power Station in Ukraine following Dniproenergo, but in contrast to Dniproenergo, Centrenergo has more transparent development plans.

Phased equipment modernisation and favourable location in a highly industrial region are the main factors that will contribute to the enterprise's income growth. Moreover, due to growing gas prices for Ukrainian consumers we predict that demand for electricity generated from coal will increase. As a result, consumption of electricity will increase, which will positively affect profits of Centrenergo.

Centrenergo's shares are highly liquid and have medium-level volatility compared to other power stations. Anticipated forward level of P/S ratio by the end of 2009 is 0.3, P/BV ratio – 0.7. **The target price is 0.94 \$ per share, which assumes 230% growth in 2009.**

3. JSC Concern Stirol (STIR) is one of the biggest fertilizer manufacturers in Eastern Europe. Stirol also produces drugs and polyethylene, but the main

share of revenues is received from fertilizers.

The enterprise has good potential for growth in the medium term, despite some risks of decline in the global fertilizer market and growing gas prices in Ukraine. Anticipated growth is driven by the global food deficit; moreover high demand for biofuel in developed countries will increase demand for fertilizers. Also, Ukraine being an important agrarian country intends to intensify cultivation of soil, which will have a positive effect on domestic demand for fertilizers.

Stirol's shares are highly liquid with lower than average level of volatility. Anticipated forward level of P/S ratio by the end of 2009 is 0.24, P/BV ratio – 0.25. **The target price is 5.75 \$ per share, which assumes 230% growth in 2009.**

4. Ukrnafta (UNAF) is the largest oil refinery in Ukraine. Ukrnafta yields about 91% of Ukraine's total oil production, as well as 27% of gas condensate and 17% of natural gas. Ukrnafta's gas processing unit is the largest producer of liquefied gas in Ukraine. Moreover, Ukrnafta has a network of petrol stations. The company has a long-term development strategy aiming at improving its vertically integrated structure, which will enable the company to create a greater variety of products and to decrease the company's dependence on the world oil prices. Current sharp decline of oil prices is the main negative impact on the enterprise. Also, there is a risk that the company will be forced to sell gas and oil for lower than market prices because of the government interventions in the enterprise's activity.

The positive fact is that in June 2008 the company changed its method of calculating rental payments. New method will reduce rental payments and increase volume of oil production. Ukrnafta's shares are highly liquid and have low volatility in comparison to the PFTS index. Anticipated forward level of P/S ratio by the end 2009 is 0.85, P/BV ratio – 0.47, P/E – 3.37. **The target price is 17.73 \$ per share, which assumes 82% growth in 2009.**

5. Poltava Ore Mining and Processing Plant (PGOK) is a turnaround ore mining plant. Its production chain covers ore mining, ore processing and production iron-ore pellets (raw material for metallurgy). Poltava Ore Mining and Processing Plant is a large exporter of iron-ore production: the enterprise exports about 85% of all output.

Decrease in demand on iron-ore products affected the PGOK insignificantly in comparison to others ore mining plants. Devaluation of the national currency and high iron-ore prices in first half of 2008 had a positive impact on the company's 2008 financial performance. Further devaluation of the national currency will favourably affect the company's revenues and profit in 2009.

Substantial capital investments which took place during 2005-2008 will increase the competitiveness of the plant in the nearest future. During the full-scale modernisation, the enterprise installed new equipment and implemented cost-cutting measures.

The plant's shares are quite liquid. Anticipated forward level of P/S ratio at the end of 2009 is 0.39, P/BV ratio – 0.59, P/E – 3.16. **The target price is 2.17 \$ per share, which assumes 52% growth in 2009.**

6. Azovstal Iron and Steel Works (AZST) is one of the largest metallurgical plants in Ukraine. In 2008 enterprise produced about 23.5% (5.5 bln tonnes) of all steel in the country and about 14.5% (4.6 bln tonnes) of the country's total cast iron output. Azovstal is a turnaround metallurgical plant and also is a part of Metinvest Group. It is vertically integrated in Metinvest Group, so Azovstal has access to necessary raw materials.

The enterprise's shares are the most liquid securities in the Ukrainian stock market. Shares can be characterised as low volatile securities in comparison with the PFTS index. Anticipated forward level of P/S ratio by the end 2009 is 0.4, P/BV ratio – 0.26, P/E – 4.6. **The target price is 0.25\$ per share, which assumes 246% growth in 2009.**

7. Alchevsk Metallurgical Plant (ALMK) is one of the largest metallurgical plants in Ukraine. After modernisation is completed in 2009 (investment of 2.2 bln USD) the plant will become one of the most modern metallurgical plants in Ukraine. In 2008 enterprise produced about 18% (4.3 bln tonnes) of all steel in the country and about 12% (3.7 bln tonnes) of the country's total cast iron output.

The plant has access to the European market, through integration with some European rolled stock enterprises. Among the most significant risks are the non-transparent management structure and quite a high level of debt.

Anticipated forward level of P/S ratio by the end 2009 is 0.1, P/BV ratio – 0.11, P/E – 2.39. **The target price is 0.025 \$ per share, which assumes 216% growth in 2009.**

8. Motor Sich (MSICH) is a unique enterprise, specialising in manufacture of helicopter engines, engines for civil aircrafts and engines for light fly machines. In addition, the enterprise constructs power stations; revenues from these operations are expected to reach to 58 mln USD in 2011.

Motor Sich possesses good production capacities and scientific base. By estimation of international law company "Solomon-group", the value of Motor Sich intangible assets exceeds 118.8 mln USD as of June 2007, 28% lower than the current market capitalisation.

Close cooperation with Russian producers of aircrafts is the main risk for Motor Sich. This risk will be partially eliminated by the launch of two helicopter engines assembling plants in Dubno and Bikovo (Russia). By assessments of the company's director, the enterprise has stock in orders for 450 mln USD in 2009. **The target price is 97.47 \$ per share, which assumes 135% growth in 2009.**

9. Sumy Frunze Machine Building Plant (SMASH) is one of the leading producers of gas in the world, as well as of equipment for oil and chemical industries. The plant manufactures drill pipes, gas-transfer stations, pumps and

pipe accessories. In the soviet era, it used to be a very important company. Also. In the early post-soviet era, the plant was one of few enterprises in this sector which had orders.

Now, the plant has a significant stock of orders. The company's financial potential permits to participate in gas-transport projects such as "The Nord Stream" (estimated value of the project is 12 bln USD), "The South Stream" (value of the project is 19-25 bln USD), the Nabucco (value of the project is 5 bln USD) and "The Yamal-Europe" (value of the project is 2.6 bln USD). Participation in these projects at least 2-5% may provide proceeds of 100-230 mln. \$ annually during nearest four years. In 2009 enterprise intends to increase production to supply its main markets – Russia and Central Asia, and to extend product range. **The target price is 3.51 \$ per share, which assumes 70% growth in 2009.**

10. Krukivsky Carriage Works (KVBZ) is a unique enterprise, producing freight cars and carriages. In 2008 enterprise manufactured 112 carriages and 6400 freight cars.

Main drivers of the company's operational profit will be a high level of ageing of railway carriages and freight cars in the CIS countries and the existing Ukrzaliznitsa projects on renovation of the entire rolling stock.

The main risk for enterprise is falling demand, first of all for freight cars. This situation is created by the economic crisis. Under current conditions the enterprise can focus its activities on passenger carriage as well as subway carriage production. Kiev Subway's administration intends to buy 100 carriages in 2009; moreover, Donetsk's Budget 2009 contains clauses that provide funding for subway building. The company plans to invest 10 mln EUR by 2012 in order to reduce its electricity and gas consumption. **The target price is 1.93 \$ per share, which assumes 165% growth in 2009.**

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