

Mining and metallurgical complex

The gradual recovery of production and the stock market's decline give rise to interesting investment ideas

July 14, 2010

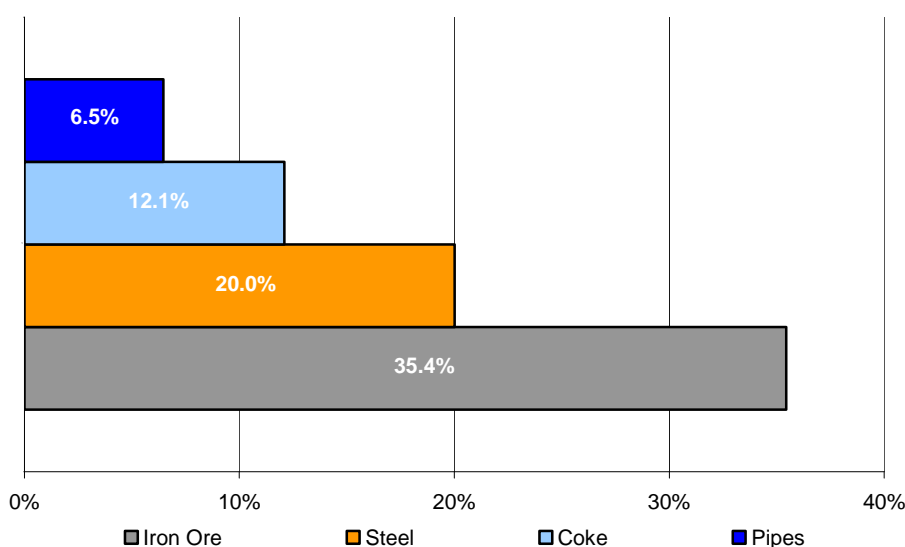
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Metallurgy

In January-June 2010, Ukrainian mining and metallurgical companies boosted production of key metallurgical products by 7%-35% YoY. Nevertheless, we must point to some degree of decline in production growth rates in June relative to April and May 2010. The key reason for this deceleration is high prices for iron ore and weaker demand for finished metal products.

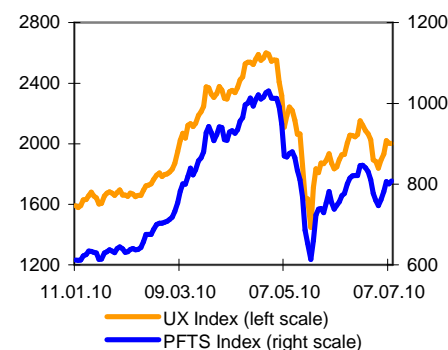
- ▶ We believe that, in 2010, companies in the mining and metallurgical complex (MMC) have good chances of achieving their planned production volumes. First of all, Ukrainian steelmakers will benefit from the fact that, being impacted by the crisis-stricken 2008-2009, most players announced rather modest targets in early 2010. In addition, a number of recent M&As in Ukrainian MMCs may contribute to improvements in the largest companies' performance in the near future.
- ▶ In May 2010, the Ukrainian stock market index fell by 44%. On July 12, at the opening of trading, the UX index was only 76% of the peak levels seen in April 2010. The general decline on the market contributed to an increase in the number of investment ideas in the metallurgy sector.
- ▶ We revaluated the fair values of 20 MMC companies' shares that are traded on the Ukrainian stock market. Based on these results, we recommend 11 MMC companies as good investment ideas.

Production increase for some metallurgical products, 6M2010 vs. 6M2009, %



Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

Ukrainian major stock indices dynamics



Companies considered by sectors

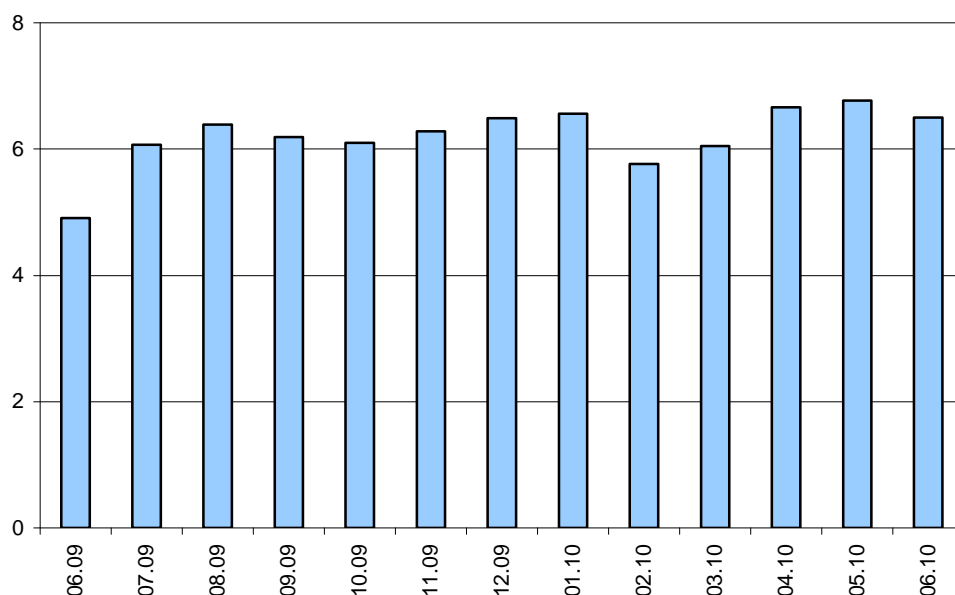
Iron ore	4
Steel	10
Coke	3
Pipes	3

Distribution of recommendations

BUY	10
including BUY (high risk)	1
HOLD	5
SELL	5

Iron ore

Iron ore output in Ukraine, mln t



Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

In June 2010, Ukrainian iron ore producers reduced output by 4% MoM and by 33% YoY compared to June 2009. The most beneficial factor for this particular market segment is the fact that the largest producers' have made the transition from annual to quarterly contracts.

According to the state-owned Derzhzovnishinform's forecast, iron ore production by Ukrainian companies in 2010 is expected to be 63.2 mln t (in 1H2010 they already produced 60% of this amount), while 11.5 mln t of this volume should be exported.

Iron-ore concentrate production by some companies

Ticker	Company	January-June 2009, thsd t	January-June 2010, thsd t	Change, %
CGOK	Central Mining	2 104	3 022	43.6%
PGOK	Poltava Mining	4 689	4 499	17.3%
PGZK	Southern Mining	2 831	4 399	55.4%
SGOK	Northern Mining	6 249	7 321	17.2%

Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

Recommendations for some companies in this segment

Central Mining (CGOK)

- The Company is the only mining enterprise that practices both open pit and deep iron ore mining.
- Practically all pellets produced by Central Mining are sold to Azovstal. Iron ore concentrate is sold in Ukraine and abroad in equal shares.
- The Company has no problems with input materials, as it has signed long-term contracts (in most cases, with its affiliated structures).

BUY
 Current price: \$0.59
 Fair price: \$0.95
 Upside: 60%

Poltava Mining (PGOK)

- Poltava Mining is the largest producer of iron-ore pellets in Ukraine.
- The Company exports about 90% of its products.
- The key shareholder in Poltava Mining is Ferrexpo AG (Switzerland), which is owned by Ferrexpo Plc. (UK), and has been listed on the main floor of the London SE since June 2008.

HOLD
Current price: \$5.13
Fair price: \$6.56
Upside: 28%

Southern Mining (PGZK)

- The Company's production capacities are both morally and physically obsolete. Over the last few years, its management has repeatedly announced modernization plans, yet it has not taken any actual steps in this direction.
- The Company is under control of Evraz (Russia) and Smart group (Ukraine).
- According to the Company's management, as of the end of 1Q2010, this mining company operated at 40% of its installed capacity.

SELL
Current price: \$0.80
Fair price: \$0.33
Upside: -58%

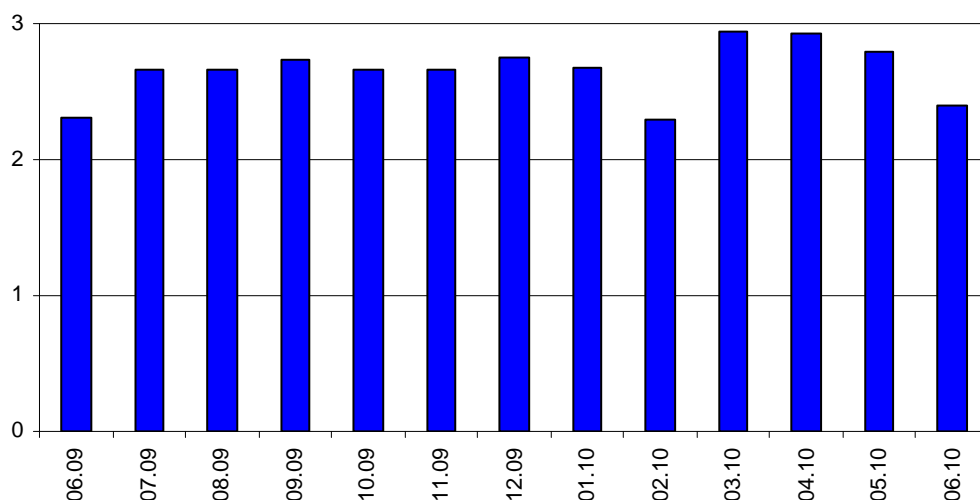
Northern Mining (SGOK)

- The Company produces about 45% of all iron-ore pellets and about 20% of iron-ore concentrate in Ukraine.
- The Company exports over 90% of the produced concentrate.
- This is one of the largest mining companies in Europe. The actual capacity of its quarries is almost 30 mln t per annum.

BUY
Current price: \$1.16
Fair price: \$1.54
Upside: 32%

Steel

Steel output in Ukraine, mln t



Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

In June 2010, Ukrainian steelmakers reduced output by 14% MoM. At the same time, production increased by 4% compared to June 2009.

The state-owned Derzhovnishinform forecasts that, in 2010, Ukrainian steelmakers will boost steel output by 12.5% YoY to 33.6 mln t (in 1H2010, they produced 48% of this volume), and the production of rolled products by 17.7% to 31.5 mln t, and of cast iron by 12.7% to 28.9 mln t.

Steel production by some companies

Ticker	Company	January-June 2009, thsd t	January-June 2010, thsd t	Change, %
AZST	Azovstal	1 879	2 870	52.7%
ALMK	Alchevsk Iron and Steel	1 769	1 626	-8.1%
DMKD	Dzerzhinsky Iron and Steel	1 760	1 444	-18.0%
DMZP	Dnipropetrovsk Petrovsky Iron and Steel	484	488	0.8%
DNSS	Dniprospetsstal	105	181	72.6%
DOMZ	Donetsk Iron and Steel	262	295	12.6%
ENMZ	Enakievo Iron and Steel	1 157	1 265	9.3%
KSTL	ArcelorMittal Kriviy Rih	2 294	3 070	33.8%
MMKI	Mariupol Illich Iron and Steel	1 898	2 686	41.5%
ZPST	Zaporizhstal	1 598	1 645	2.9%

Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

Recommendations for some companies in this segment

Azovstal (AZST)

- The Company is characterized by a full closed cycle of metal production.
- Azovstal produces about 15% of all steel products in Ukraine and enjoys a monopoly in terms of the production of wide gage railroad rails and joint bars.
- In December 2008, the Company completely made the conversion from natural gas in its blast-furnace production. Now, Azovstal uses coke as its fuel.

BUY
Current price: \$0.35
Fair price: \$0.58
Upside: 67%

Alchevsk Iron and Steel (ALMK)

- Since the Company's shareholders do not include any mining enterprises, the steelmaker has to sign long-term contracts with the competitors' companies for inputs' supply.
- Alchevsk Iron and Steel is a monopolistic producer of stainless plates and two-layer steel sheets.
- By the summer of 2011, the Company plans to commission a gas-turbine station, coal injection facilities, and its blast furnace no. 2.

HOLD
Current price: \$0.022
Fair price: \$0.028
Upside: 26%

Dzerzhinskiy Iron and Steel (DMKD)

- The Company is a monopolist in terms of the market for wide-strip universal steel and the steel sections.
- This is the only Ukrainian supplier of rolled axle billets for railroad transport, sheet piles, and contact rails for metro lines.
- About half of Company's products are sold in Ukraine. The remainder is exported.

BUY
Current price: \$0.06
Fair price: \$0.08
Upside: 36%

Dnipropetrovsk PetrovskySteel (DMZP)

- The Company is an important to CIS entities as a supplier of rolled products for the automotive industry, tram rails, die-rolled sections for colters, steel forms for the car building industry, as well as hunch plates.
- There are no compatible products in the world to the rails produced by this Company.
- The Company is not affiliated with any mining enterprises, so it must sign long-term contracts for inputs' supply with its competitors.

BUY
Current price: \$0.06
Fair price: \$0.10
Upside: 76%

Dniprospetsstal (DNSS)

- In late spring 2010, the Company experienced problems with its waste removal. Earlier, the land plot used for these purposes had been seized by raiders. Until the Company resolves its problem with respect to industrial waste removal, it will continue to suffer financial losses.
- Dniprospetsstal is one of the leaders on the CIS market in terms of the market for special metallurgy products.
- The Company's core products include section iron and forged products from special grades of steel.

SELL
Current price: \$193
Fair price: \$111
Upside: -43%

Donetsk Iron and Steel (DOMZ)

- The Company specializes in the production of the hot-rolled sheets from carbon and alloyed construction grades of steel.
- In June 2010, the Company shut down its blast furnaces and suspended cast iron production. Its officials explained that this move was due to a lack of demand for its cast iron. The Company exports more than half of its products and is heavily dependent on global market conditions. We see the market value of the steelmaker's shares (\$0.011) as extremely low. Therefore, as soon as demand recovers, its shares should enjoy a sizeable upside.
- The Company's shares not very liquid. However, if the liquidity of the Ukrainian stock market improves, we believe that its shares may be among the growth leaders.

BUY
(high risk)
Current price: \$0.011
Fair price: \$0.045
Upside: 330%

Enakievo Iron and Steel (ENMZ)

- The Company does not use the obsolete open-hearth practice in its steel production. This advantage is especially strong in the face of constantly growing prices for natural gas.
- The steelmaker exports about 90% of its products.
- By 2015, the Company plans to use coal dust in all its iron-melting furnaces.

BUY
Current price: \$22.7
Fair price: \$38.7
Upside: 71%

ArcelorMittal Kriviy Rih (KSTL)

- The Company specializes in producing reinforced steel and rods from regular and low-alloyed grades of steel, as well as producing sinter, concentrate, coke, cast iron, profile, and section iron.
- The Company lost a series of suits in Ukrainian courts connected with its failure to fulfill its agreements. As a result, it had to pay over \$50 mln as compensation to representatives of the Privat group (Ukraine).
- In our opinion, the Company's position on the Ukrainian market is rather strong. However, its shares are significantly overvalued by the market.

SELL

Current price: \$1.31

Fair price: \$0.36

Upside: -73%

Mariupol Illich Iron and Steel (MMKI)

- The steelmaker's management has resolved the problem with the lack of a guaranteed supply of base materials by signing a long-term (25-year) agreement with the Metinvest group.
- At the Company's general meeting on July 1, 2010, shareholders decided to increase the chartered capital by 3.7 times, and include the Metinvest group in its shareholders structure. As a result, the latter should be able to consolidate a 75% stake in Mariupol Illich Iron and Steel.
- The Company produces about 12% of all rolled products in Ukraine, while this figure is about 15% for steel, and 14% for cast iron.

HOLD

Current price: \$0.41

Fair price: \$0.43

Upside: 4%

Zaporizhstal (ZPST)

- The Company is strongly dependent on iron-ore materials, since it has no input sources of its own.
- Plans to make the transition from open-hearth to convertor steel production by 2012, which the Company had announced in 2008, has been suspended. The Company's management reached an agreement with the Zaporizhia Regional Council that it will prolong the operation of its open-hearth furnaces until 2017.
- The sale of about a 50% stake in the steelmaker in 2010 has been challenged in a London court. The litigation is expected to last for about one year.

SELL

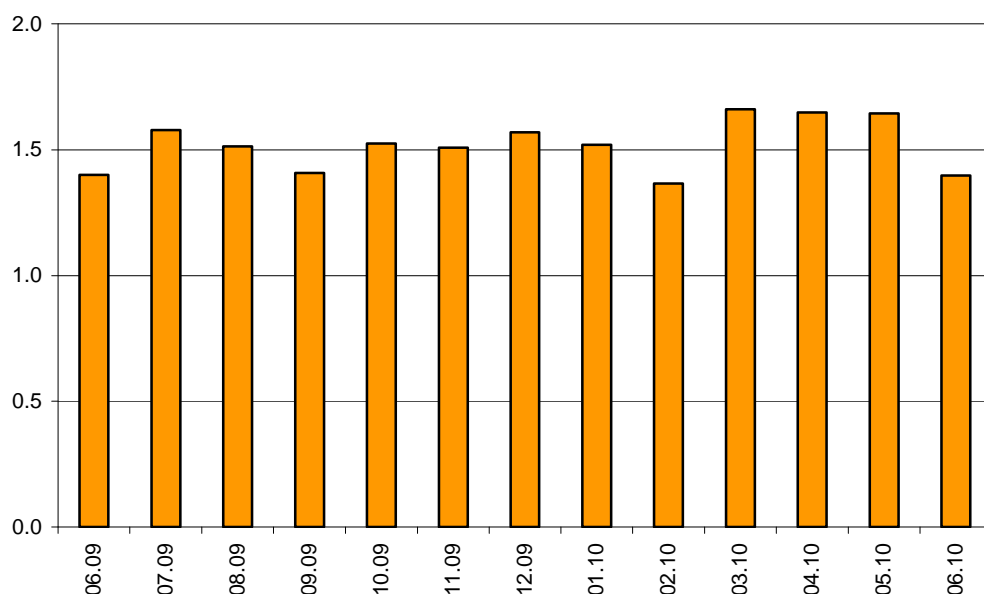
Current price: \$0.82

Fair price: \$0.28

Upside: -66%

Coke

Coke output in Ukraine, mln t



Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

In June 2010, Ukrainian coke producers reduced output by 15% MoM, while it remained at the same level seen in June 2009, at 2.4 mln t. Derzhzovnishinform forecasts that coke production will reach 18.9 mln t in 2010 (in 1H2010, output had reached 49% of that volume). At the same time, exports should amount to 1.1 mln t.

Coke production by some companies

Ticker	Company	January-June 2009, thsd t	January-June 2010, thsd t	Change, %
AVDK	Avdiivka Coke	1 252	1 589	26.9%
ALKZ	Alchevsk Coke	1 660	1 637	-1.4%
YASK	Yasinovka Coke	710	778	9.6%

Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

Recommendations for some companies in this segment

Avdiivka Coke (AVDK)

- The Company produces for about 20% of all coke produced in Ukraine.
- After the Metinvest group's expected entry in the chartered capital of Mariupol Illich Iron and Steel, Avdiivka Coke should be able to completely re-orient itself towards the domestic market.
- Avdiivka Coke's balance sheet includes a controlling interest in Krasnodonvugillia, the Company's key supplier of raw materials.

HOLD

Current price: \$1.63

Fair price: \$1.65

Upside: 1%

Alchevsk Coke (ALKZ)

- The Company specializes in the production of blast-furnace coal, pitch, coal charge, benzole, and ammonia sulphate.
- The Company has recently been selling almost all its products on the domestic market.
- The coke deficit on the domestic market will be a main factor contributing to an increase in companies' revenues this year compared with 2009.

BUY
Current price: \$0.06
Fair price: \$0.14
Upside: 158%

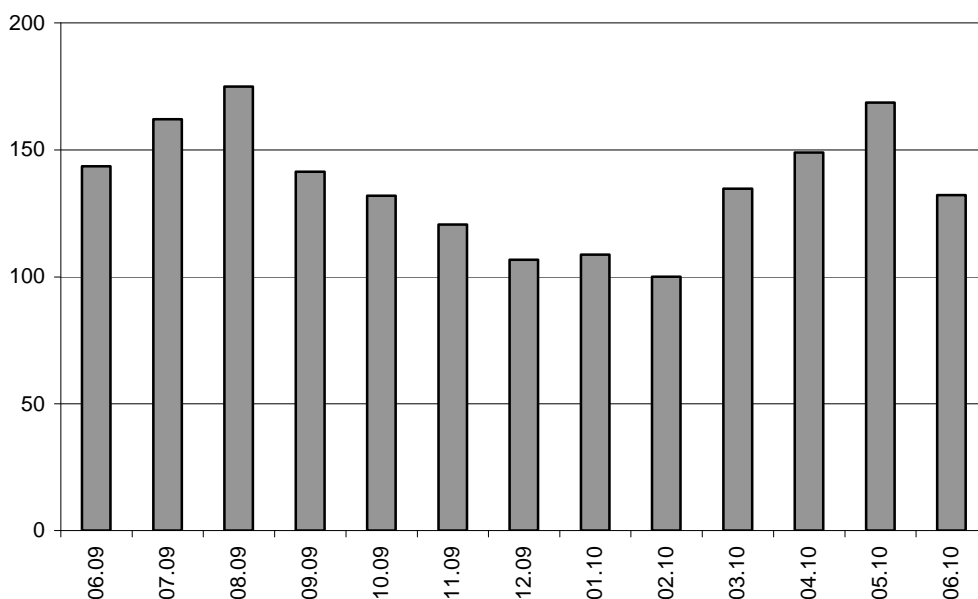
Yasinovka Coke (YASK)

- The Company produces coal coke, blast-furnace coke, small-grained coke, foundry coke, nut coke, and breeze coke, as well as a wide range of by-coke products.
- The Company has no problems with its coking coal supply, since its key supplier – the Pokrovskoe Mine – is an affiliated structure.
- After the expected acquisition of a 75% in Mariupol Illich Iron and Steel by the Metinvest group, the Company should be able to re-orient itself towards exports.

BUY
Current price: \$0.43
Fair price: \$1.05
Upside: 142%

Pipes

Pipes output in Ukraine, thsd t



Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

In June 2010, Ukrainian pipe producers reduced their output by 22% MoM. This represents an 8% decline from June 2009. The announcement that Gazprom (Russia) intends to buy 700 thsd t more pipes this year presents a good opportunity for Ukrainian pipes producers to boost their net sales.

Pipe production by some companies

Ticker	Company	January-June 2009, thsd t	January-June 2010, thsd t	Change, %
HRTR	Khartsyzsk Tubes	303	104	-65.5%
NITR	Interpipe Nizhnedniprovsky Tube Rolling	96	164	70.2%
NVTR	Interpipe Novomoskovsky Tubes	53	82	56.6%

Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

Recommendations for some companies in this segment

Khartsyzsk Tubes (HRTR)

- The Company produces over 500 standard sizes of steel longitudinal large-diameter welded pipes for main gas pipelines and oil pipelines.
- Its production capacity amounts to about 1.6 mln t of pipes per annum, including 665 thsd t of tubes with corrosion-resistant coating.
- The Russian-based Gazprom has announced that it expects its orders for large-diameter pipes to increase by 700 thsd t by the end of 2010. We expect that Khartsyzsk Tubes will receive at least a part of this order.

BUY

Current Price: \$0.16

Fair price: \$0.33

Upside: 112%

Interpipe Nizhnedniprovsky Tube Rolling (NITR)

- The Company's core product is 152-530 mm steel seamless and welded pipes.
- Interpipe Nizhnedniprovsky Tube Rolling sells about 50% of its products in the CIS (primarily in Russia) and about 30% is sold on the domestic market.
- The Company's faces problems in exporting its products due to anti-dumping duties introduced by a number of countries. In our opinion, NITR shares are significantly overvalued by the market.

SELL

Current Price: \$1.32

Fair price: \$0.34

Upside: -74%

Interpipe Novomoskovsky Tubes (NVTR)

- Its production capacities exceed 430 thsd t of steel welded pipes.
- In late 2008, its parent company, Interpipe Limited, signed an agreement with the Company for the provision of a €200 mln loan. The blank loan is provided without collateral until 2018.
- The Company actively diversifies its raw materials' suppliers. At present, the bulk of its base materials are purchased from Russian, Ukrainian, and Eastern-European companies.

HOLD

Current Price: \$0.37

Fair price: \$0.43

Upside: 16%

Upside of some mining and metallurgical companies' shares

Ticker	Company	Recommendation	Current price, \$	Fair price, \$	Upside
<i>Iron ore</i>					
CGOK	Central Mining	BUY	0.59	0.95	60%
PGOK	Poltava Mining	HOLD	5.13	6.56	28%
PGZK	Southern Mining	SELL	0.80	0.33	-58%
SGOK	Northern Mining	BUY	1.16	1.54	32%
<i>Steel</i>					
AZST	Azovstal	BUY	0.35	0.58	67%
ALMK	Alchevsk Iron and Steel	HOLD	0.022	0.028	26%
DMKD	Dzerzhinsky Iron and Steel	BUY	0.06	0.08	36%
DMZP	Dnipropetrovsk Petrovsky Iron and Steel	BUY	0.06	0.10	76%
DNSS	Dniprospevsstal	SELL	193	111	-43%
DOMZ	Donetsk Iron and Steel	BUY (high risk)	0.011	0.045	330%
ENMZ	Enakievo Iron and Steel	BUY	22.7	38.7	71%
KSTL	ArcelorMittal Kriviy Rih	SELL	1.31	0.36	-73%
MMKI	Mariupol Illich Iron and Steel	HOLD	0.41	0.43	4%
ZPST	Zaporizhstal	SELL	0.82	0.28	-66%
<i>Coke</i>					
AVDK	Avdiivka Coke	HOLD	1.63	1.65	1%
ALKZ	Alchevsk Coke	BUY	0.06	0.14	158%
YASK	Yasinovka Coke	BUY	0.43	1.05	142%
<i>Pipes</i>					
HRTR	Khartsyzsk Tubes	BUY	0.16	0.33	112%
NITR	Interpipe Nizhnedniprovsky Tube Rolling	SELL	1.32	0.34	-74%
NVTR	Interpipe Novomoskovsky Tubes	HOLD	0.37	0.43	16%

Sources: Interfax-Ukraine, Ukrainskie novosti, UFC Capital estimates.

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