

Ukraine

Concern Galnaftogaz

Review of 2006 IFRS financials

Oil product retailers

The independent OJSC Concern Galnaftogaz controls about 7% of the local oil product retail market. We maintain our Marketperform recommendation on its outstanding bonds.

OJSC Concern Galnaftogaz has disclosed its 2006 audited consolidated financial accounts compiled under IFRS standards. The company continued its strong revenue growth, with net sales up 34% YoY to US\$514.7m and the CAGR in revenues reaching 40% in 2003-06.

Profit generation improved in 2006 as the EBITDA margin reached 5.1%. However, the bottom-line margin dropped to 1.6% on the back of bigger financial costs during the year.

Galnaftogaz continues to invest in network expansion in the country's eastern oblasts (regions), which are more densely populated and industry-heavy. It mainly uses debt as a source of financing. While debt on the balance sheet grew from 40.2% of assets at end-2005 to 47.7% of assets at end-2006, Galnaftogaz maintains a healthy liquidity position, which improved over 2006, reinforcing our view on the company.

Local-currency bonds issued by Concern Galnaftogaz

Bond	Curr	Cpn (%)	Amount (Pm)	Maturity	Price	YTP (%)	Spread* (bp)	MD
UA130076AD09 (OGNGD)	UAH	12	30	25-Jun-10	101.750	10.47	340	0.90
UA130076AE08 (OGNGE)	UAH	12	30	26-Jul-10	100.603	12.00	493	0.95
UA130076AF07 (OGNGF)	UAH	14	30	26-Aug-10	100.793	8.12	105	0.13

Note: Prices are as at 9 July 2007, and are clean and expressed as a percentage of face value.

* Spread to government bond due in December 2009; all bonds have annual put options.

Source: PFTS, ING

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Maintained (since 09/06/06)

Marketperform

Bloomberg

GLNGUZ

19 July 2007

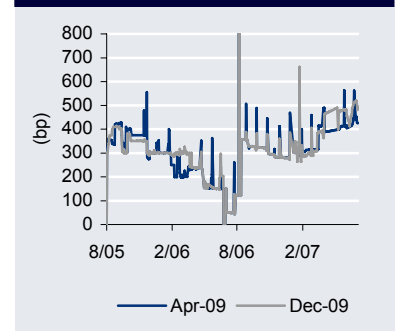
Key IFRS financials (US\$m)

	2004	2005	2006
Sales	241.9	385.1	514.7
EBITDA	8.5	16.2	26.2
Net income	4.2	8.0	8.3
Assets	89.7	163.8	248.6
Equity	38.3	61.9	89.1
Debt	27.4	65.8	118.6
CFO	3.0	(13.7)	11.3
CFI	(11.8)	(20.7)	(44.2)
CFF	9.6	35.1	40.1
Capex	11.6	19.5	42.8

Key ratios

	2004	2005	2006
EBITDA margin (%)	3.49	4.70	5.10
Net margin (%)	1.73	2.08	1.61
EBITDA/int exp (x)	7.59	3.79	2.56
Debt/EBITDA (x)	3.24	4.06	4.52
ST debt/debt (%)	13.79	53.13	40.74
Debt/assets (%)	30.54	40.15	47.71
Current ratio (x)	1.31	1.21	1.30
Quick ratio (x)	1.09	0.99	1.03
Cash ratio (x)	0.10	0.05	0.14

Spreads over government bonds



* Source: PFTS, ING

Key credit considerations

Positives

Concern Galnaftogaz positions itself as an independent oil product retailer focused on customer service

Independent, customer-focused oil product retail network. OJSC Concern Galnaftogaz has positioned its network of filling stations as multi-function retail sites serving car owners not only through gasoline pumps but also as universal outlets meeting driving customers' needs to the widest extent possible. This strategy stems partly from its ownership structure, in which private investors dominate. The company's controlling shareholders are not affiliated with any oil company, making its strategy independent from the task of selling the products of one particular oil company. Instead, the company is flexible in terms of suppliers, tending to provide its customers with higher-quality products and hence trying to win customer loyalty.

Audited IFRS consolidated financials are available for 2003-06

Higher level of transparency than the local market average. OJSC Concern Galnaftogaz's management cooperates with financial institutions and capital market investors more extensively than is usual in the local market. It has been auditing its consolidated financials in accordance with IFRS since 2003, readily disclosing information on the company's operations beyond the requirements of Ukraine's securities market regulator.

It holds about a 7% market share...

One of the leaders in the sector. The local oil product retail market is still fairly fragmented and competitive. A number of companies form parts of larger business groups with interests in the upstream oil business. However, Concern Galnaftogaz holds about 7% share of the market and is among the top three oil retail companies.

... delivering strong growth in sales and improving EBITDA margins

Rising revenues and cost efficiency. Over 2003-06, Concern Galnaftogaz managed to increase its net sales at a 40.2% CAGR. In 2006, sales rose 33.7% YoY to UAH2.6bn (US\$514.7m). Better cost efficiency in 2006 resulted in the EBITDA margin increasing to 5.1%, from 4.7% the previous year.

Concerns

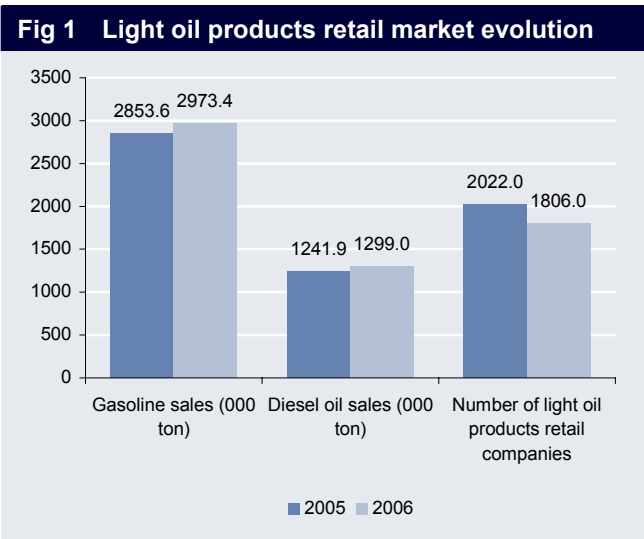
Competition for market share forces Galnaftogaz to employ more debt

Competition for market share. As we mentioned above, the market is fairly fragmented, providing room for further sector consolidation. Given its independence from large business groups, Concern Galnaftogaz has to rely on its own resources to finance its capital expenditure programme. In the competition for market share, Galnaftogaz has increased the amount of debt on its balance sheet, immediately causing a lowering of its debt servicing and debt repayment metrics. However, successful implementation of the business expansion should restore them to healthy levels.

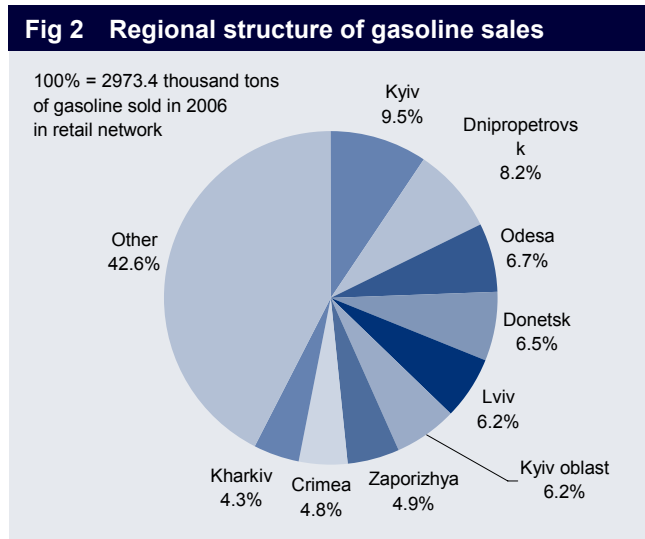
Market review

The oil product retail market grew 4.2% YoY in gasoline sales and 4.6% YoY in diesel oil sales

The domestic light oil products retail market has been experiencing consolidation and reasonable growth. The total volume of gasoline sold in 2006 via filling station retail networks grew 4.2% YoY to nearly 3.0m tons. Diesel oil sales reached 1.3m tons in 2006, up 4.6% on the volume sold in the previous year. In a growing market, retail businesses are facing consolidation. There is no clear market leader for the time being; however, it is natural to see a declining number of companies in the sector. At the end of 2006, there were 1,806 companies in the sector, down 10.6% YoY.



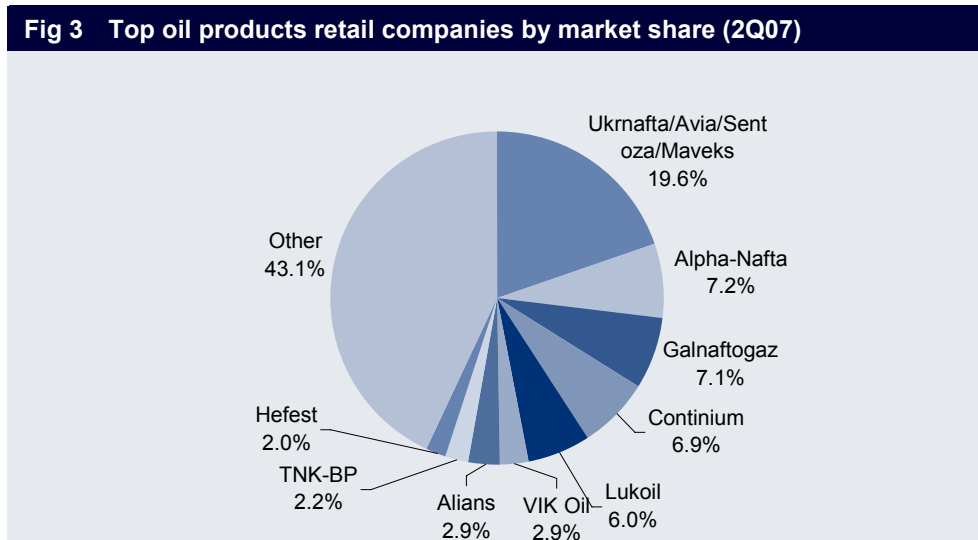
Source: State Statistics Committee



Source: State Statistics Committee

Sector fragmentation provides a room for consolidation

The market is still considered to be fairly fragmented, with the top eight oil products retail companies controlling a 37.3% share of the market and the largest retailer, which comprises several brand networks (Ukrnafta, Avia, Sentoza and Maveks), controlling a 19.6% market share, according to market research from Lviv-based Universal Investment Group (UIG).



Source: Universal Investment Group

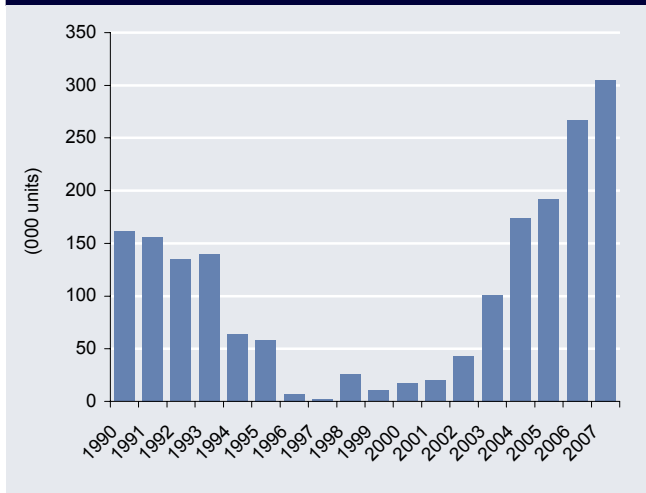
Foreign ownership in the sector is limited to Russian oil companies

Foreign presence in the sector is currently limited to Russian oil companies such as Lukoil and TNK-BP. The consolidation trend within the market is likely to attract foreign direct investments.

Car market conditions should benefit oil product retail market prospects

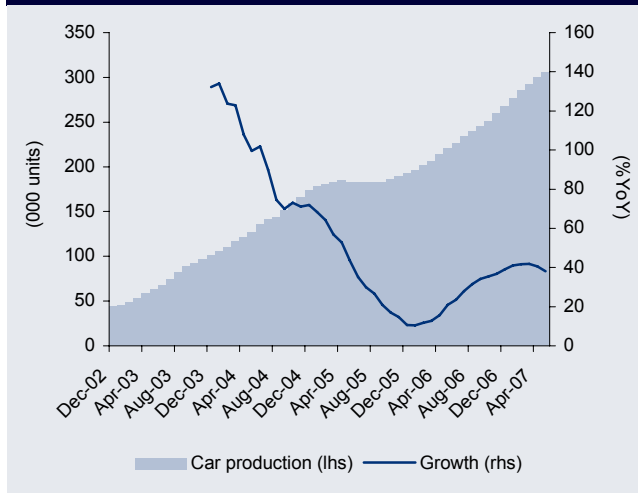
Generally, the market is being driven by wider usage of motor vehicles among consumers and by increased business activity. In particular, consumers enjoying growing disposable income are creating the basis of demand for cars, especially in the new car market. Greater availability of credit for car purchases is also fuelling this strong demand. Ultimately, this demand is resulting in larger oil product sales in filling stations.

Fig 4 Ukraine's car production history, 1990-2007



Note: Data for 2007 is annualised production as at 1 June 2007. Source: State Statistics Committee

Fig 5 Annualised car production and growth

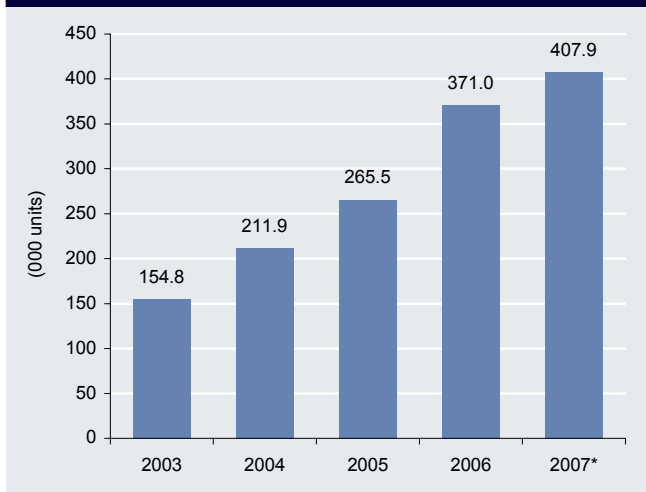


Note: Car production volumes are annualised. Source: State Statistics Committee

Consumer demand for cars is strong, supporting the domestic car industry and imports

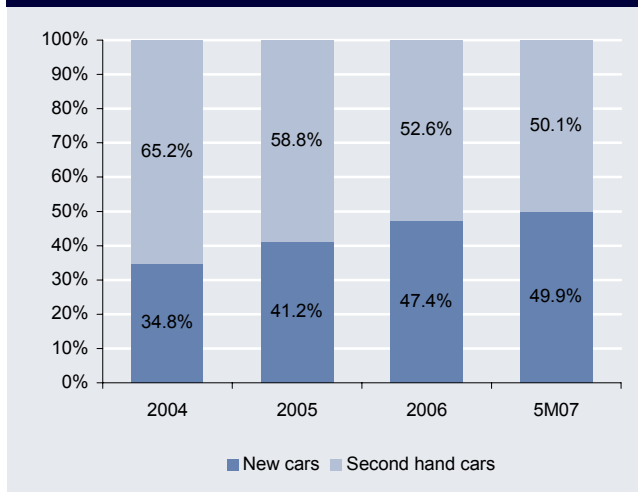
As evidence of the strong consumer demand for cars, the domestic car industry has been expanding both production and the product range (producing mainly foreign-brand cars), while more affluent consumers have been driving up demand for foreign-made cars. Car production has risen dramatically over the past five years, and annual car production of more than 300,000 units has now overtaken car output in the pre-1990s Soviet Ukraine.

Fig 6 New car sales in Ukraine



* For a 12-month period ended on 31 May 2007. Source: AutoConsulting

Fig 7 Structure of the local car market



Source: AutoConsulting

However, it is worth noting that most car purchases are still in the secondary car market (a 50.1% share in January-May 2007).

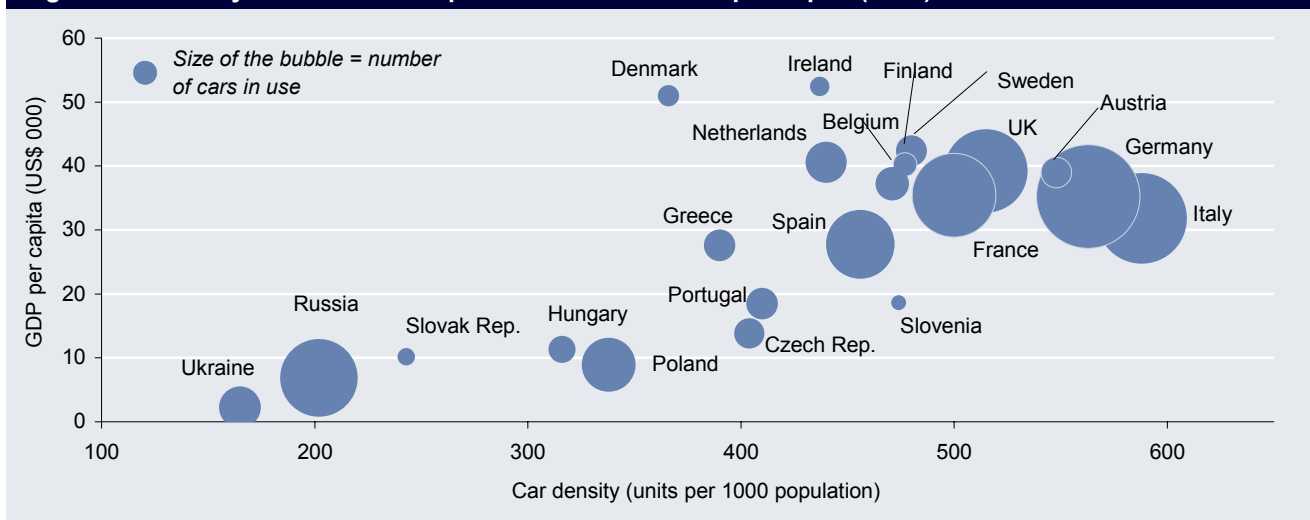
Low car density in Ukraine means the oil product retail market will see a rise in demand...

... as car ownership should at least catch up with neighbouring countries

In terms of car density, the market has substantial room for further growth. The number of cars used per 1,000 people was 165 as at the end of 2006, according to the State Statistics Committee's survey of households. This is marginally lower than in most Central and Eastern European countries, let alone developed Western European countries.

While the city of Kiev already experiences regular traffic jams because of its highest household income level and hence higher-than-average car usage ratio and the pure traffic infrastructure designed in the 1960s and at the latest the 1980s, car usage in other areas of the country is set to rise as well, as household incomes follow economic growth trends. In this regard, the oil product market should definitely benefit from the trend, and its growth prospects are well supported.

Fig 8 Car density in selected European countries vs GDP per capita (2006)



Source: State Statistics Committee of Ukraine, European Automobile Industry, national sources

Financial analysis

Performance of Concern Galnaftogaz

Concern Galnaftogaz has extended its network of filling stations into eastern Ukraine...

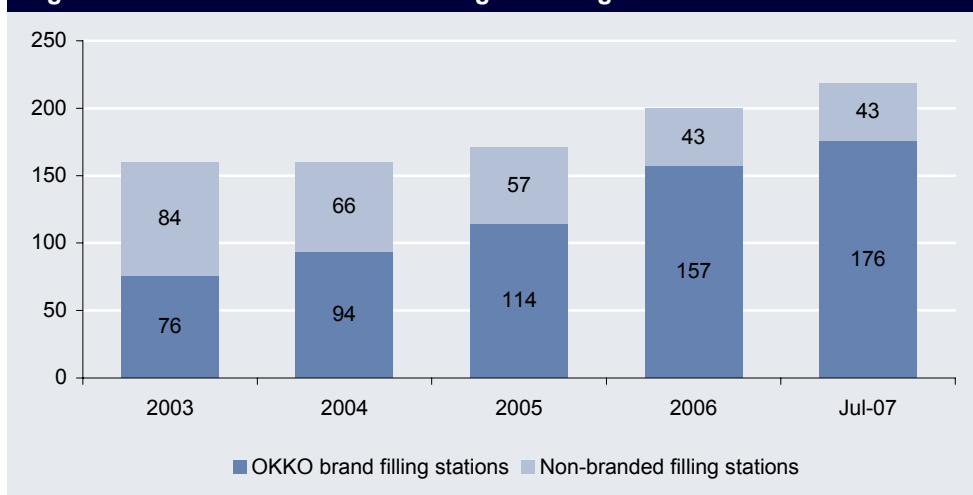
Galnaftogaz has grown from its home base of the Lviv oblast into being one of the dominant market players in the western oblasts of the country, which border Poland, Hungary and Slovakia. In 2003, the company established a foothold in Ukraine's most lucrative market, Kiev city, which benefits from the highest level of oil product sales. Over 2006 and 1H07, OJSC Concern Galnaftogaz has been fulfilling its strategy of expanding the network of OKKO brand filling stations into new areas of the country – mainly the eastern oblasts, which have sizeable populations and relatively higher household income levels thanks to their economy's mostly industrial nature.

... by acquiring smaller competitors and building filling stations itself

The company expands via acquiring smaller retail companies with their own small networks of filling stations and rebranding them to OKKO brand outlets. Alternatively, it acquires plots of land and constructs filling stations from scratch. At the beginning of July, Galnaftogaz's network of filling stations comprised 176 OKKO brand stations and 43 non-branded ones.

At the beginning of July 2007, there were 219 stations in the network

Fig 9 Evolution of Concern Galnaftogaz's filling station network

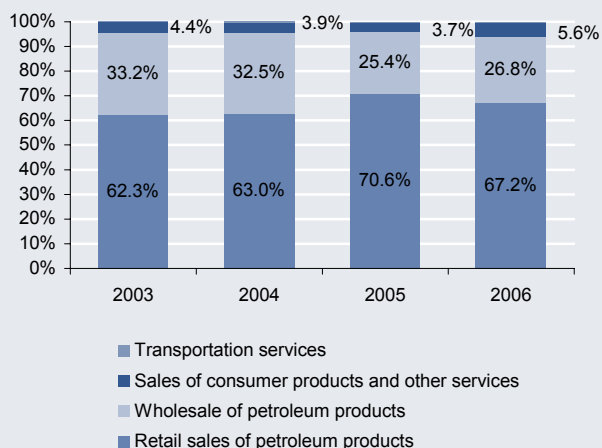


Source: Company data

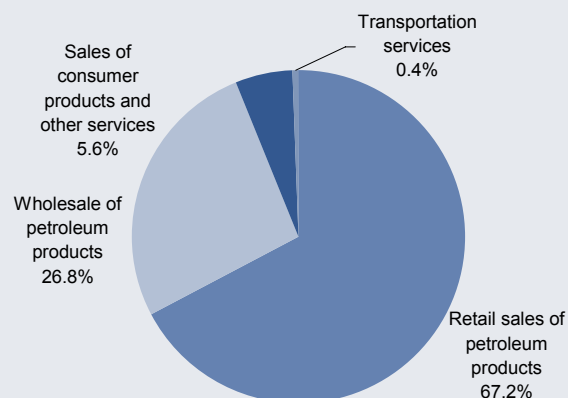
Filling stations under the OKKO brand offer a range of services and products essential to driving customers. In this way, Concern Galnaftogaz has positioned itself as an oil product retail company with a universal approach of serving its customers, enjoying in return their loyalty and a diversification of revenue sources.

67% of sales come from retail, 27% from wholesale, and 6% from selling other goods and services

While retail and wholesale oil product sales naturally represent the bulk of revenues – a 94% share in 2006 – proceeds from selling services and goods at filling stations doubled last year, reaching UAH145.6m (US\$28.8m), or a 5.6% share of 2006's UAH2.6bn (US\$514.7m) sales.

Fig 10 Evolution of revenue structure


Source: Company data

Fig 11 Breakdown of 2006 revenue by segment


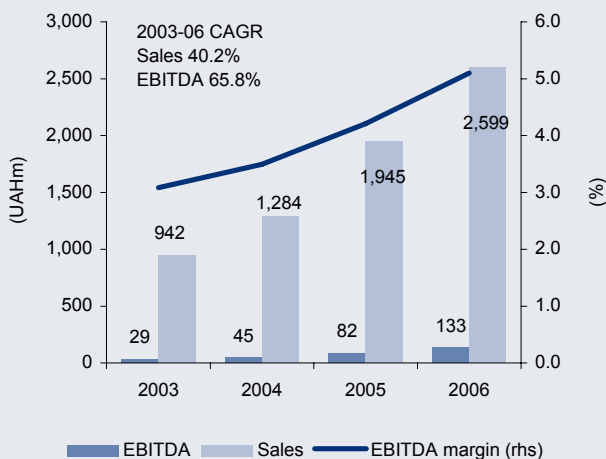
Source: Company data

Revenues grew at a 40% CAGR in 2003-06...

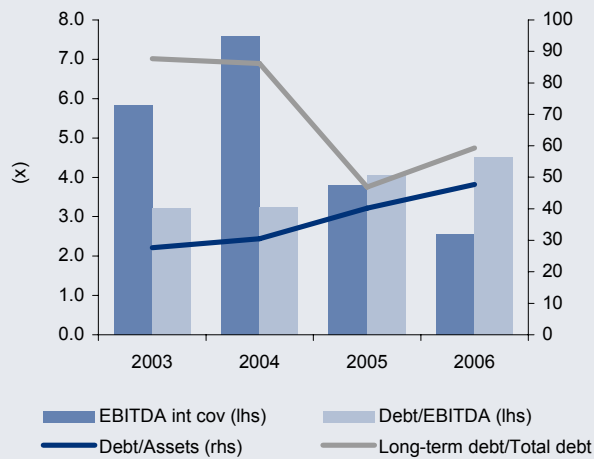
In terms of financial performance, the company's net sales rose 33.7% YoY in 2006, reaching UAH2.6bn (US\$514.7m), while the cumulative growth rate has been even more impressive over the last three years at a 2003-06 CAGR of 40.2%. This trend reflects the company's strengthening market positions in new oblasts and in the sector in general.

... reaching more than US\$500m in 2006

In 2006, the company showed further improvements in cost management, which were transformed into higher earnings margins. Thus, in 2006, the company reached an EBITDA margin of 5.1%, up from 4.7% in 2005.

Fig 12 Dynamics of revenues and earnings


Source: Company data

Fig 13 Debt payment and leverage ratios


Source: Company data

2006 capex amounted to US\$43m, double the previous year's level...

In 2006, Concern Galnaftogaz's capital expenditure programme was aggressive, with the company spending UAH216.3m (US\$42.8m) during the year, while capex the previous year amounted to just UAH98.4m (US\$19.5m).

... largely financed by debt financing

The capex programme was financed primarily through borrowed funds, resulting in increased company leverage as debt accounted for 47.7% of assets at the end of 2006, up from 40.2% a year earlier. The debt burden on earnings inched up as well as debt to EBITDA moved from 4.1x in 2005 to 4.5x in 2006. EBITDA interest coverage fell from 3.8x in 2005 to 2.6x in 2006.

However, one positive in the company's borrowing activity is that it is extending the maturity of its debt: long-term debt's share of total debt size had risen to 59.3% by the end of 2006, up from 46.9% at the beginning of the year.

Peer comparison

Of all the country's oil product retailers, only Concern Galnaftogaz is publicly traded on the local bond market. This is why we compare its financials with public companies from emerging European economies.

Galnaftogaz has a better EBITDA margin than its peers...

Galnaftogaz's improved earnings margins (a 5.1% EBITDA margin) stand out from those of comparable companies, with Turkish Petrol Ofisi AS enjoying a 4.2% margin and Slovenian Petrol AD operating with an even slimmer 2.4% margin.

... showing its healthy liquidity position

While enjoying good liquidity positions in terms of current liabilities' coverage by current assets and by the portion of them that excludes inventories, Galnaftogaz looks more capital-intensive than its peers, spending more on business expansion, which explains its higher debt burden in the balance sheet.

Fig 14 Concern Galnaftogaz's financial figures and ratios vs selected peers, 2006 (US\$m)

	OJSC Concern Galnaftogaz (Ukraine)	Petrol Ofisi AS (Turkey)	Petrol DD (Slovenia)	Petrol AD (Bulgaria)
No of filling stations	219	3500	361	446
Credit ratings (Moody's/S&P/Fitch)	-/-	-B+/BB-	-/-	CCC+/-/B-*
Key financial figures** (US\$m)				
Sales	514.69	17,302.84	2,561.94	827.09
EBITDA	26.24	733.79	62.20	26.72
Net income	8.31	315.81	65.76	8.31
Assets	248.62	8,813.23	1,113.00	389.04
Cash	10.45	946.03	37.84	40.04
Equity	89.11	3,424.32	523.80	111.52
Liabilities	159.40	5,382.94	589.20	277.52
Debt	118.61	1,408.17	243.12	167.91
ST debt	48.31	382.67	114.76	36.20
Net debt	108.16	462.14	205.28	127.87
Ratios				
EBITDA margin (%)	5.10	4.24	2.43	3.23
Net margin (%)	1.61	1.83	2.57	1.00
EBITDA interest coverage (x)	2.56	4.61	5.01	4.29
Debt/EBITDA (x)	4.52	1.92	3.91	6.28
Net debt/EBITDA (x)	4.12	0.63	3.30	4.79
Debt/assets (%)	47.71	15.98	21.84	43.16
Debt/equity (x)	1.33	0.41	0.46	1.51
Equity/assets (%)	35.84	38.85	47.06	28.67
Long debt/total debt (%)	59.26	72.82	52.80	78.44
Current ratio (x)	1.30	1.96	0.97	1.46
Quick ratio (x)	1.03	1.42	0.72	0.84
Cash ratio (x)	0.14	0.45	0.09	0.28

* S&P downgraded Petrol AD from B- to CCC+ with a negative outlook, citing the company's weak corporate governance as it broke a covenant within its €100m bond indenture and an ongoing legal dispute between Petrol AD and Russia's Lukoil over the retail fuel supply agreement.; Fitch also put a negative outlook on the company's rating.

** Translated from national currencies into US dollars using exchange rates for 2006

Source: Company data

Financials

Fig 15 Summary income statement (UAH 000)

	2003	2004	2005	2006
	audited IFRS	audited IFRS	audited IFRS	audited IFRS
Sales	942,375	1,283,605	1,944,616	2,599,175
Cost of goods sold	-897,692	-1,222,630	-1,830,841	-2,443,822
Gross income	44,683	60,975	113,775	155,353
Selling, general & administrative expenses	-22,449	-30,979	-45,848	-65,598
Other operating income/(expenses)	-2,832	357	-5,060	17,876
Operating income	19,402	30,353	62,867	107,631
Finance expense	-7,768	-5,708	-14,140	-51,825
Pre-tax income	12,623	27,952	50,234	55,806
Income tax	-1,536	-5,704	-9,745	-13,839
Net income	11,087	22,248	40,489	41,967

Source: Company data

Fig 16 Summary balance sheet (UAH 000)

	2003	2004	2005	2006
	audited IFRS	audited IFRS	audited IFRS	audited IFRS
Current assets				
Cash & cash equivalents	9,308	13,348	16,342	52,766
Accounts receivable	60,569	89,929	239,619	209,719
Inventories	15,156	30,210	72,042	104,990
Other current assets	20,993	45,677	72,298	130,277
Total current assets	106,026	179,164	400,301	497,752
Non-current assets				
Property, plant & equipment (PPE)	179,194	239,895	405,818	739,084
Intangible assets	8,930	7,777	8,123	7,112
Investments	35,249	41,986	2,264	0.031
Other non-current assets	6,692	7,210	10,614	11,529
Total non-current assets	230,065	296,868	426,819	757,756
Total assets	336,091	476,032	827,120	1,255,508
Current liabilities				
Accounts payable	62,984	113,092	154,161	138,507
Loans & borrowings	11,461	20,049	176,434	244,006
Other current liabilities	7,247	4,050	0.736	0.553
Total current liabilities	81,692	137,191	331,331	383,066
Non-current liabilities				
Loans & borrowings	81,674	125,327	155,657	354,965
Other non-current liabilities	4,787	9,608	26,782	66,929
Total non-current liabilities	86,461	134,935	182,439	421,894
Minority interest	0.048	0.494	0.560	0.523
Shareholders' equity	167,890	203,412	312,790	450,025
Total liabilities & shareholders' equity	336,091	476,032	827,120	1,255,508

Source: Company data

Fig 17 Ratios (% , if not otherwise indicated)

	2003	2004	2005	2006
Profitability indicators				
Gross margin	4.74	4.75	5.85	5.98
EBITDA margin	3.08	3.49	4.70	5.10
EBIT margin	2.06	2.36	3.70	4.14
Net margin	1.18	1.73	2.08	1.61
Return on average assets (ROAA)	6.59	5.49	6.33	4.03
Return on average equity (ROAE)	13.20	12.01	15.99	11.00
Debt-payment indicators (x)				
Pre-tax interest coverage	3.88	5.14	2.91	2.08
EBITDA interest coverage	5.82	7.59	3.79	2.56
Debt/EBITDA	3.21	3.24	4.06	4.52
Debt/CFO	4.62	9.19	-4.79	10.49
Debt/FCFO	-1.13	-3.17	-1.98	-3.76
Net debt/EBITDA	2.89	2.94	3.86	4.12
Net debt/CFO	4.16	8.34	-4.55	9.57
Net debt/FCFO	-1.01	-2.88	-1.88	-3.43
Leverage indicators				
Debt/assets	27.71	30.54	40.15	47.71
Debt/capital	55.46	71.30	105.98	132.94
Long-term debt/total debt	87.69	86.21	46.87	59.26
Short-term debt/total debt	12.31	13.79	53.13	40.74
Liquidity indicators (x)				
Current ratio	1.30	1.31	1.21	1.30
Quick ratio	1.11	1.09	0.99	1.03
Cash ratio	0.11	0.10	0.05	0.14
Turnover indicators (days)				
Receivables turnover	23	26	45	29
Inventory turnover	6	9	14	16
Payables turnover	25	33	30	20

Source: Company data

Disclosures Appendix

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Outperform: expected 1-year total return that modestly exceeds the 1-year expected total return of the relevant market.

Marketperform: expected 1-year total return that will be in line with the 1-year expected total return of the relevant market.

Underperform: expected 1-year total return that is modestly below the 1-year expected total return of the relevant market.

Sell: expected 1-year total return that is significantly below the one-year expected total return of the relevant market.

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Bucharest Tel: 40 21 222 1600	Geneva Tel: 41 22 593 8050	Manila Tel: 632 840 8888	Prague Tel: 420 2 5747 1111	Sofia Tel: 359 2 917 6400
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