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**Market information**

Bloomberg	GLNG UZ
Frankfurt/Xetra	C9Z GR
No of Shares, mln	16,000.0
Reg S GDR to Ord.	1:500
Market price, USD	0.015
52Wk H/L, USD	0.016/0.008
MCap, USD mln	240.0
Free float	20%
FF MCap, USD mln	48.0

Mo avg tr volume*, USD mln	0.019
MCap turnover*	0.04%

\* 6M trailing, PFTS & Frankfurt

**Stock ownership**

F.I.E.H. and related	80%
Other	20%

**Ratios, 2005 IFRS**

EBITDA Margin	4.2%
EBIT Margin	3.2%
Net Margin	1.9%
Net Debt/Equity	0.63

**Galnaftogaz has gained 39% YTD and is currently trading 36% above our target. The arguments that justify and challenge the market price appear to balance out. We expect 2006 IFRS accounts in a week or two; in the meantime, we put our target and recommendation under review.**

**Is the market correct? Pros/Cons**

- + Corporate governance premium could have been priced in, it also could justify putting more weight on an asset-based valuation
- + The market could have assessed the company's perpetuity growth rate to be higher than we did
- + Alternative stocks in Ukrainian retail are scarce
- No positive surprises so far, 2006 results generally lagged behind our forecasts
- Expensive compared to peers

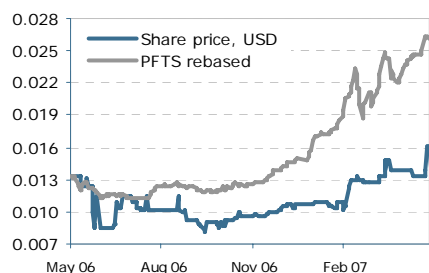
**The management comments on 2006 results**

In expectation of 2006 IFRS accounts, we discussed last year's performance and market developments with management:

- Top line as expected; average sales per station and contribution of convenience goods increased in line with forecasts.
- EBITDA margin improved in 2006, but lagged behind both our and the management's forecasts. Based on preliminary data, net margin dropped in 2006 from 2.0% to 1.6%. The management says 2007 markups will be more secure due to cost-plus pricing for wholesale purchases. However the state is still attempting to limit retailers' prices through capping margins in absolute terms.
- Number of stations at the end of 2006 was 200, 12 stations below our forecast. In 2007 the company plans to launch 87 stations net, 63 stations more than in 2006.
- According to company data, its market share increased from 5.2% to 7.1% in 2006 (0.2 p.p. above our forecast), making it the third largest fuel retailer in Ukraine.
- Galnaftogaz increased its share of imports in its fuel basket to reduce dependency on local refineries. In general, retailers are gaining more power over refineries.
- The management confirmed Galnaftogaz's IPO plans, saying that the placement will probably happen at the end of 2008.

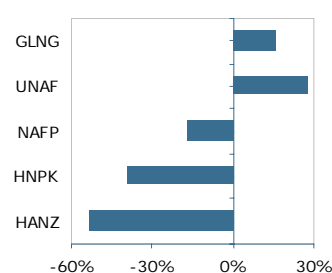
Once we see 2006 IFRS financials, we will carefully review our model and valuations.

**Stock performance vs. PFTS**

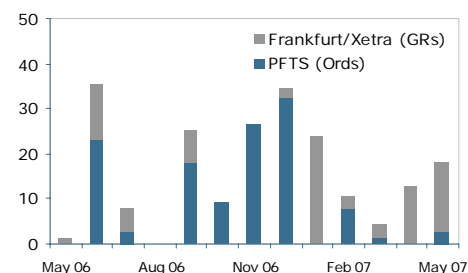


Source: PFTS, Bloomberg

**Sector performance, YTD**



**Trading volume, USD thousand**



**Key financials & ratios**

(in USD mln)	Sales	EBITDA Margin	Net Margin	EV/S	EV/EBITDA	P/E
2005	379.5	4.2%	1.9%	0.73	17.46	33.41
2006E	507.0	5.4%	2.0%	0.64	11.84	24.14
2007E	645.4	6.1%	2.0%	0.58	9.46	18.33

Spot exchange rate: 5.05

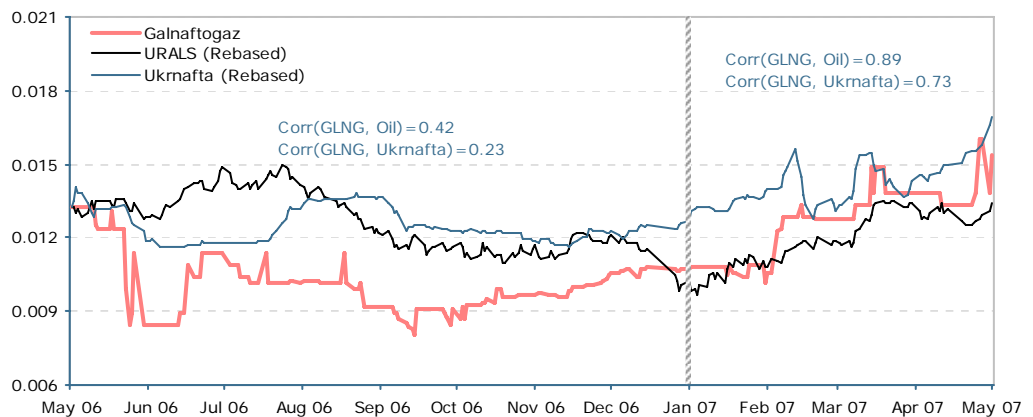
## Galnaftogaz Gains 39% YTD. Why?

In the half a year since we attached a HOLD recommendation to Galnaftogaz, it surprised us with 39% YTD growth. Currently, the stock trades at USD 0.015 per share, 36% above our November target of USD 0.011 per share. Meanwhile, we have not observed any positive surprises in regards to the company's fundamentals. The question becomes what is behind the recent upsurge.

**Pricing in a corporate governance premium.** Galnaftogaz received the highest rating in our February corporate governance survey. It is possible that the market priced in a "corporate governance" premium to the stock.

**Following oil prices/stocks.** During last 12 months, a correlation between Galnaftogaz and Ukrnafta's stock prices was quite high, 0.74. Correlation with URALS prices increased significantly over the last five months to an incredible 0.89, from 0.42 last year.

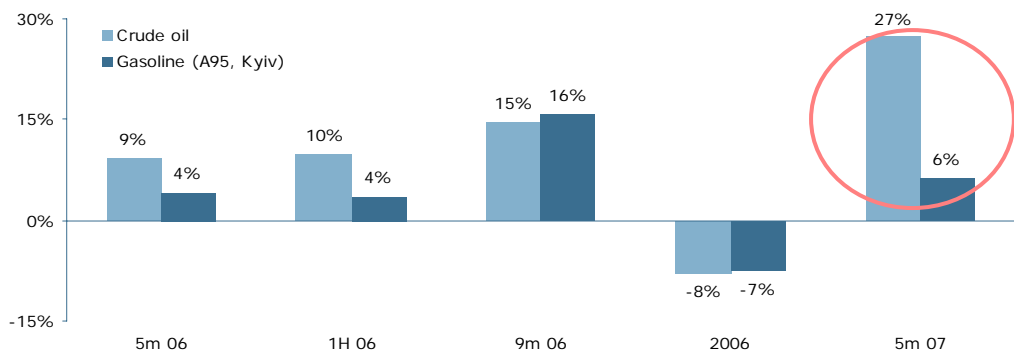
### Galnaftogaz stock performance vs. Ukrnafta and URALS, USD/share



Source: PFTS, Bloomberg; daily data

The positive correlation between Galnaftogaz, oil prices and upstream oil stocks can be justified only if higher oil prices proportionally translate into retail prices for oil products, leaving margins safe. Although last year it seemed to be the case, this year retail prices have significantly lagged oil prices. We think that the extremely high correlation between Galnaftogaz's stock and oil prices in 5M07 is not well justified.

### Gasoline vs. oil prices: YTD changes in 2006 and 2007\*



\* For oil prices, a 1 month lag was assumed. E.g., 5M change in gasoline price is shown against 4M change in oil prices.  
Source: Company data, Bloomberg, Concorde Capital estimates

An important question is whether the increase is justified and sustainable. So far, it looks like pros and cons compensate for each other. The company's 2006 IFRS accounts (expected in one or two weeks) will probably shed more light on the issue; in the meantime, we put our target and recommendation under review.

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