Equity Markets

Initiating coverage

Ukraine

XXI Century

Pausing for breath

Real estate

Price (21/02/06)
820p

ING WHOLESALE BANKING

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Initiating coverage

Hold

22 February 2006

Target price (12 mth)
903p

Bloomberg
XXIC LN

XXI Century is one of the leading real-estate development and property management companies in Ukraine. Its portfolio consists of shopping centres, deluxe residential buildings and a variety of land sites yet to be developed.

Rapidly expanding portfolio. XXI Century has three operating segments: retail property, residential development and commercial real estate. The group is planning a massive expansion of its property portfolio over the next four years, from 18,000m^2 to over 300,000m^2. The retail division's leasable area is forecast to grow eightfold to 145,000m^2 by 2008, while the commercial portfolio could reach 170,000m^2 from scratch. The residential portfolio also has ten sites at various stages of planning, totalling 285,000m^2.

We forecast significant earnings growth. The growth in leasable space and the delivery of residential projects over the next few years are the main drivers for earnings growth. We forecast significant growth in earnings in 2006 to US$18.8m, as residential projects are completed. Additional project completions in 2007 are expected to drive growth by a further 77%.

We initiate with a HOLD. Since the IPO the shares have gained 40% in sterling terms. We value the company at US$588m or 903p per share, implying 10% upside from current levels. With the shares trading on 1.55x NAV, in line with Orco, it is difficult to justify anything more than a HOLD at this stage of the company's development.

Forecasts and ratios (US$m)

Year to Dec	2004	2005F	2006F	2007F
Revenue	5.4	9.0	32.8	91.3
EBITDA	-0.7	5.1	23.6	43.8
EBIT	1.2	2.6	16.2	35.0
Net income	1.6	2.0	18.8	33.3
EPS (US$)	0.05	0.05	0.50	0.89
PER (x)	281.4	264.5	28.3	16.0
EV/EBITDA (x)	N/A	78.0	18.0	9.8
P/BV (x)	29.8	2.4	2.1	1.8

Source: Company data, ING estimates

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12-month forecast returns (%)

Share price (US$)	10.1
Dividend (US$)	0.0
12m f'cst total US$ return	**10.1**

Key ratios (%)

	2005F	2006F
EBITDA margin	56.4	71.9
Operating margin	18.9	51.7
Net debt/equity	-61.1	-42.8
P/NAV	1.55	1.38
ROCE	0.7	5.2

Interim data (US$m)

	1H04	1H05
Revenue	2.40	2.83
Gross profit	1.51	1.30
EBIT	-0.37	-1.02
Net income	1.95	0.71

Share data

No. of shares (m)	37.3
Daily t/o (US$m)	N/A
Free float (%)	35.7
Mkt cap (US$m)	534
Mkt cap (£m)	306

Share price performance (GBP)

Source: Bloomberg

Contents

Company summary

A leading property developer in Ukraine

XXI Century is one of the leading real-estate development and property management companies in Ukraine. Its portfolio consists of shopping centres, deluxe residential complexes and a variety of land sites acquired for retail and residential development, as well as commercial, industrial and hotel investment. With a ten-year track record of real-estate investment, the company has significant experience in the capital, Kyiv.

Active in retail, residential and commercial property

The group has three operating segments: retail property, residential development and commercial property. XXI Century is planning a massive expansion of its property portfolio over the next four years, from 18,000m^2 to over 300,000m^2. The retail division's leasable area is forecast to grow eightfold from 18,000m^2 to 145,000m^2 by 2008, while the commercial portfolio could reach 170,000m^2 from scratch.

Kvadrat is the leading shopping centre operator

Kvadrat Ukraine is the leading domestic developer and operator of shopping centres. The company intends to expand the network in Kyiv, adding another five shopping centres with a total floor plate of 205,000m^2 within the next few years. More than 55,000 shoppers visit the Kvadrat chain each day and the brand name is recognised by 85% of Kyiv residents, making Kvadrat the most widely known shopping centre chain in the capital.

The residential division has ten sites to be developed

Zhytlo XXI Century designs and develops business class and high-end residential real-estate projects in Kyiv. It is currently developing two apartment buildings containing 47 and 186 high-end units in the city centre, due to be completed in 2006-07. The company has a project portfolio of ten sites in various stages of planning and development throughout Kyiv, totalling 285,000m^2.

We forecast significant growth in profits

The growth in leasable space and the delivery of residential projects over the next few years are the main drivers for earnings growth. We forecast earnings growth of 30% in 2005 to US$2m and then to rise sharply in 2006 to US$18.8m, as new retail projects are completed. We expect profits to then nearly double in 2007 to US$33m. Earnings growth should then be sustained out to 2009 when new project completions start to slow on current forecasts.

Valuation

We have valued XXI Century using two methods, a net operating income model and sector comparatives. The former gives us a value of US$442m and the latter US$734m. We have taken the average value of US$588m as a fair value, which gives us a target price of 903p. With 10% upside we initiate with a Hold recommendation.

Market summary

The domestic economic backdrop is supportive

Although the economy has slowed, the macro backdrop is still supportive to the real-estate sector. GDP is forecast to grow 3% this year, a slowdown from over 12% in 2004, but an improvement from 2005 and enough to continue the growth in demand for real-estate space. Investment is also forecast to pick up, which will affect demand for retail, commercial, industrial and residential property, thereby aggravating the lack of supply.

Kyiv has a severe shortage of commercial real estate

Compared with other cities in the region, Kyiv has a pitifully low level of commercial real estate. The total area of office premises in Kyiv at the end of 2004 was 0.34m m^2. Even Moscow has over 1.4m m^2 and Warsaw, which is a similar sized city, has around 2m m^2. What makes the situation worse is that the figure includes all office stock, from class A to C, which would not be suitable for any international company.

Demand is strong but currently limited by supply

Demand for good quality office space continues to be strong, but is limited by the lack of supply. The vacancy rate is thus expected to fall further from 5% last year to just 3% in 2006. Vacancy rates are closer to 1% in the CBD where much of the high-quality office space is located. Demand for large premises comes mainly from foreign companies, although the share of Ukrainian tenants has also been growing.

Retail space is also limited

Although retail real estate has been growing steadily, there is still huge potential for development, as just US$150m has been invested in the past five years. Land availability and consumer spending growth make investment in this sector particularly favourable. Kyiv currently has approximately 95m^2 of shopping centre space per 1,000 residents, of which less than half can be regarded as of sustainable quality.

The residential segment is starting to grow

Residential construction is one of the most rapidly developing sectors of Kyiv's economy. There is currently just 18.5m^2 of residential property per city resident in Kyiv. This is forecast to increase to 35m^2 in ten years. However, the high-end residential property segment is only just developing, although the rapid growth of mortgage lending after new legislation should help drive this sector's growth.

Yields are high but falling gradually

Another attraction is the level of yields compared with Western and Central Europe, although there are very few secondary transactions to base this on. Vendors of quality offices offer their property for yields of between 10% and 16%. The trend is clearly downward, although gradual. This follows the trend in the rest of Eastern Europe and Russia, which are a few years ahead of Ukraine in terms of real-estate development.

Valuation

We have used two valuation methods

We have used two methods to value XXI Century, net operating income (NOI) and sector comparisons. We view NOI as the most appropriate method, as it gives a breakdown of the value of each asset, using discounted cash flow methodology. However, the comparatives provide a useful benchmark to valuation, using current market multiples. We have looked at the comparative traded companies in the region, although these are not all directly comparable.

Net asset value

DTZ estimated NAV of 100% of the portfolio at US$272m

DTZ estimated the NAV of the total portfolio, excluding future development opportunities, at US$272m. Were it to include these other potential assets, it would be US$8m higher at US$280m. However, the DTZ valuation is calculated assuming that XXI Century controls 100% of all its assets, which is not always the case. If we adjust for its shareholdings in each project, then the total NAV would be US$212m, or US$206m if future development opportunities are excluded, as in Figure 1.

Fig 1 DTZ valuation report

	Type	Annual rent (US$m)	Total NAV (US$m)	Stake (%)	XXI Century value (US$m)
Lukyanivka**	Retail	2.44	13.16	67	8.82
Borschahivka	Retail	2.63	15.61	50	7.81
Investment property		**5.06**	**28.77**	**58**	**16.62**
		MV on completion			
Capitolium	Residential	18.4	9.30	74	6.91
Parus	Residential	30.16	4.90	74	3.64
Property in construction		**48.56**	**14.20**	**74**	**10.55**
Luteranska	Residential	51.1	11.16	50	5.58
Posolsky Dvir	Residential	77.7	26.18	74	19.45
Yaroslaviv Val	Residential	42.5	7.15	37	2.66
Hetman	Residential	20.0	2.85	74	2.12
Kyianivsky	Residential	217.0	50.92	44	22.61
Voznesensky Yar	Residential	84.5	10.63	74	7.90
Lypska	Residential	19.5	6.04	74	4.49
Perova	Retail	61.1	14.97	100	14.97
Lisova	Retail	76.8	14.08	100	14.08
Balzaka	Retail	7.5	2.17	100	2.17
Myloslavska	Retail	92.0	24.28	100	24.28
Vyshhorod	Industrial	45.0	2.27	99	2.25
Virlytsia	Mixed	380.0	56.21	100	56.21
Property for development		**1,174.6**	**228.90**	**78**	**178.76**
DTZ valuation			**271.9**		**205.9**
Verkhnia*	Residential	18.2	1.12	74	0.83
Tolstoho*	Residential	61.3	5.34	74	3.96
Kruty Uzviz*	Residential	16.4	1.42	74	1.05
Future development sites		**95.9**	**7.88**	**74**	**5.85**
Total portfolio			**279.7**	**76**	**211.8**

*Lease pending. **Minorities have been bought out since this valuation was completed

Source: DTZ, company data, ING estimates

DTZ assumptions in line with RICS guidelines

DTZ makes various assumptions, including that all properties are developed as stipulated in the existing lease, which is not always what the company is planning for a land site. The discount rate that is used assumes that no debt is employed and is thus an equity IRR. It also assumes that the property is retained on completion. DTZ has also applied its own commencement date and development period for each property, as well as no benefit for the company of developing multiple properties or releasing them to the market at the same time. As Figure 1 shows, the market value on completion that DTZ assumes is significantly higher than the NAV arrived at, which suggests that DTZ's discount rates must be high. Potential future development opportunities are also excluded, where leases are pending.

NAV has its drawbacks as a methodology

NAV provides a useful benchmark to our valuation exercise, but it is not ideal, as it is an historical measure that only takes account of existing projects. It does not incorporate the full value from future projects. It is also not able to account fully for the company's growth prospects or the ability of management to generate future returns for the business. It also assumes that yields remain at current levels and do not adjust to the downward trend in the region. Another drawback is that it does not reflect the ability of the company to refinance debt and release capital for further development, on completion of projects.

Net operating income

We have used quite conservative assumptions

Our net operating income analysis provides a project-by-project breakdown of the company's portfolio. We have laid out our assumptions in Figure 2, which shows that we are using a yield of 17.6% for each of the retail projects and 15% for the commercial and residential. In our view, these yields are conservative, especially for the retail assets, but they are the averages used by DTZ in its calculations for existing retail property, so we have applied the same rate to be consistent.

We have discounted future projects back to the present day

For the commercial projects (office/industrial) we have taken the annual rental income, adjusted for operating costs, where appropriate, to reach net operating income and discounted this by our yield assumption, to reach a valuation for each project. This has then been adjusted for the shareholding that the company holds in each project. For investment assets that are under development we have discounted back from the completion date at the stated discount rate. For the residential assets we have taken the expected cash inflow from each development, subtracted the costs to completion and used a 15% discount rate to reach our NPV for each project, discounting back for however many years there are to delivery. Again, we have adjusted for the shareholding where it is less than 100% to reach our fair value.

We estimate an equity value of US$439m under this method

The result is that we have a value of US$17m for existing retail projects and US$100m for new Kvadrat developments. For the new commercial assets we ascribe a value of US$114m, assuming that Virlytsia is all delivered in 2012. The residential projects currently being developed are valued at US$14m and the sites awaiting development are valued at US$55m. Adjusting for other assets, this gives us an enterprise value of US$304m. Adding the year-end 2005 estimate for net cash gives us an equity value of US$442m.

Fig 2 NOI model (US$m)

	NRA (m^2)	Monthly rate (US$/$m^2$)	Annual rate (US$/$m^2$)	Occupancy (%)	Actual revenue	Service costs	Total NOI	Yield (%)	Stake (%)	Completion date	Value (US$m)
Lukyanivka	6,160	36	430	100	2.6	-0.7	2.0	17.6	100	2003	11.2
Borschahivka	11,820	21	250	100	3.0	-0.8	2.2	17.6	50	2003	6.1
Retail	**17,980**	**26**	**312**	**100**	**5.6**	**-1.5**	**4.1**				**17.3**
Perova	18,080	26	312	95	5.4	0.0	5.4	17.6	100	3Q07	14.2
Lisova	33,450	26	312	95	9.9	0.0	9.9	17.6	100	1Q09	26.3
Myloslavska	32,500	26	312	95	9.6	0.0	9.6	17.6	100	4Q08	25.6
Virlytsia	40,000	26	312	95	11.8	0.0	11.8	17.6	100	4Q09	31.5
Balzaka	3,400	26	312	95	1.0	0.0	1.0	17.6	100	2Q07	2.7
New retail	**127,430**		**296**		**37.7**	**0.0**	**37.7**				**100.3**
Virlytsia Offices	106,780	34	408	95	41.4	-1.2	40.2	15.0	100	2007-12	79.3
Luteranska**	350	135		65	26.6	-16.2	10.4	15.0	50	2007	26.2
Vyshhorod	80,000	7	85	90	1.5	-0.1	1.4	15.0	99	2007	8.3
Kruty Uzviz*	11,000	34	408	90	4.0	-0.1	3.9	15.0	74	2008	0.0
New commercial	**162,780**		**452**		**73.6**	**-17.6**	**55.9**				**113.7**
	Total (m^2)	**Price (US$/$m^2$)**	**Sales**	**DF**	**Contract costs**	**Net**	**NPV**	**Discount (%)**			
Capitolium	11,598	2,380	27.6	0.87	13.4	14.2	12.3	15.0	74	2006	9.8
Parus	28,954	1,326	38.4	0.76	31.2	7.2	5.4	15.0	74	2007	4.3
Residential	**40,552**		**66.0**		**44.6**	**21.4**	**17.8**				**14.2**
Hetman	17,993	1,845	33.2	0.76	22.2	11	8.3	15.0	74	2007	7.1
Posolsky Dvir	17,500	3,000	52.5	0.66	30.0	22.5	14.8	15.0	74	2008	12.6
Kyianivsky	52,500	2,200	115.5	0.57	70	45.5	26.0	15.0	44	2009	13.3
Yaroslaviv Val	22,215	2,053	45.6	0.66	29.6	16	10.5	15.0	37	2008	4.5
Voznesensky Yar	75,000	1,600	120.0	0.57	89	31	17.7	15.0	74	2009	15.1
Verkhnia*	28,000	2,000	56.0	0.66	32.8	23.2	15.3	15.0	74	2008	0.0
Tolstoho*	28,000	2,200	61.6	0.66	37.2	24.4	16.0	15.0	74	2008	0.0
Lypska	3,570	2,493	8.9	0.76	4.8	4.1	3.1	15.0	74	2007	2.6
New residential	**244,778**				**315.6**	**177.7**	**111.8**				**55.3**
Other assets											2.8
Enterprise value											**303.6**
Net debt											138.7
Equity value											**442.3**

*Land lease pending, **Numbers refer to rooms and room rate

Source: Company data, ING estimates

Comparative valuation

The average premium to NAV in the region for 2006 is 100%

In Figure 3 we provide the market ratings of comparable property development companies in the region, as an illustration of the current valuation of the EMEA real-estate sector. The average premium to NAV for 2006 is currently 110%. If applied to XXI Century this would value the company at US$734m. None of the other valuation metrics really apply to XXI Century, as the company is not expected to be profitable enough to use an average PER or EV/EBITDA multiple for 2005 or 2006 earnings.

Fig 3 Property development sector comparatives

	Rating	Target price (US$)	Price (US$)	Mkt Cap (US$m)	NAV (US$) 2005F	NAV (US$) 2006F	P/NAV (x) 2005F	P/NAV (x) 2006F	PER (x) 2006F	EV/EBITDA (x) 2006F
GTC	Sell*	56.8*	79.6	1,588	27.1	30.9	2.9	2.6	21.1	30.6
Open Investments	Hold*	94.3*	145.0	521	64.4	74.8	2.3	1.9	14.0	11.0
Orco Property Group	Buy*	110.0*	95.7	649	58.4	65.3	1.6	1.5	14.3	12.9
Average ING universe				**2,758**	**149.9**	**171.0**	**2.4**	**2.1**	**17.5**	**20.8**
XXI Century	Hold	15.8	14.3	535	9.2	10.4	1.6	1.4	28.9	18.4

*Recommendations and target prices maintained. Prices as at 17 February 2006
Source: Company data, ING estimates

Fig 4 XXI Century comparative valuation

	2005F	2006F
P/NAV (x)	2.4	2.1
XXI Century value (US$m)	**835**	**734**

Source: Company data, ING estimates

Valuation summary

In summary, we have used two methods to value the company, each of which have their merits, as well as laying out the DTZ appraisal value from last year. Our preferred method is the NOI model as it incorporates more of the company's growth prospects than a more historical measure like the NAV. Figure 5 provides a comparison of the valuations, which range from US$442m to US$734m. The average valuation is US$588m or US$15.76 per share, equivalent to 903p. This would value the company at 1.6x NAV, which is in line with Orco's current valuation.

Fig 5 XXI Century valuation summary 2006F (US$m)

NOI model	442.3
Comparatives	734.3
Average	**588.3**
Target price (US$)	**15.76**
Target price (p)	**903**

Source: ING estimates

Risks

The main risks to our forecasts and valuation are the supply and demand of real estate in Kyiv, the level of interest rates, rate of economic growth, construction inflation and exchange rates.

Developments since the IPO

Three tenders won outside Kyiv since IPO

The biggest development since last December is that XXI Century has won three land tenders in Zaporizhia, in south-eastern Ukraine, an industrial city of 1m people. Two of the sites are residential and one is commercial. The total area of the three plots is 4.7 hectares and the cost was just US$1.2m. None of the plots have any rezoning issues, as the general concept for the development is stipulated in the tender and it is up to the bidder to decide the exact details within a range of options. The lease lengths are all 49 years and the total expected area of the developments is 155,000m^2. It is difficult to estimate the value of these land sites at this stage, but the company estimates that the elite residential development could attract prices of US$2,000-2,500/m^2. This would suggest revenue from the two residential sites of over US$250m.

Fig 6 Zaporizhia projects

	Hectares	Area m^2	Cost of land (US$m)	Lease life (yrs)	Zoning	Project
Residential	0.9	50,000	0.1	49	Completed	Residential complex
Residential	2.0	70,000	0.7	49	Completed	Elite/business class residential
Commercial	1.9	35,000	0.36	49	Defined by City	Entertainment Centre
Total	**4.8**	**155,000**	**1.16**			

Source: Company data

Progress at Perova and Balzaka

The first new Kvadrat development at Perova broke ground on 28 December. Rentals are being negotiated and over 80% of the floor space has been pre-leased, despite raising the rental levels, due to the strength of demand. Part of the IPO proceeds will be used to complete construction. The other Kvadrat centres are going through an accelerated planning and design phase. Demand has been good for the space and pre-lease rates are rising. The smallest of the five new centres, Balzaka, is expected to be completed by mid-2007, which will give the company useful experience with tendering and letting.

New leases expected to be signed soon

On the residential side, sales are continuing at Capitolium and Parus, which are now 74% and 11% pre-sold, respectively, as at 7 February 2006. Management expects the lease for Verkhnia to be signed by the mayor soon, allowing it to be included in the 1H06 financials. Tolstoho should also be signed soon, but is likely to be included in the 2H06 numbers. On the commercial side, the lease at Kruty Uzviz is also likely to be resolved in 2H06.

Company background

Background

One of Kyiv's largest portfolios of real-estate assets

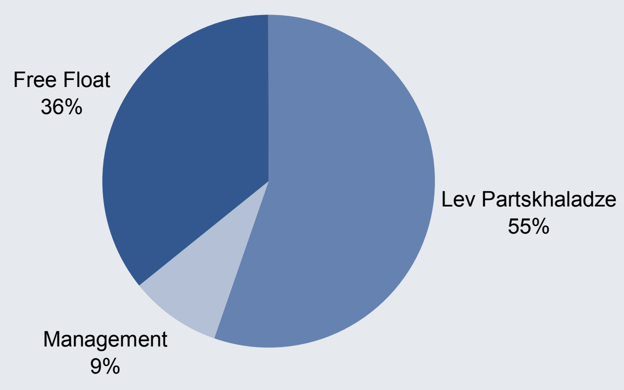
XXI Century is the Cypriot registered holding company for the assets of one of the leading real-estate development and property management companies in Ukraine. The business was founded in 1995, focused on real-estate development from 1998 and began diversifying its operations further in 2002. Its portfolio consists of shopping centres, deluxe residential complexes and a variety of land sites acquired for further retail and residential development, as well as commercial, industrial and hotel investment. The company currently has one of the largest portfolios of real-estate assets in Kyiv and, with a ten-year track record in the market, it has significant experience and detailed knowledge of real-estate investment and asset management of the capital.

Shareholder structure

Management currently has a 9% stake in the company

The company is controlled 55% by the Chairman of the Supervision Board, Lev Partskhaladze, the founder of the XXI Century group. Since the IPO, outside investors have held 36% of the stock. The remaining 9% is held by management under a stock ownership programme intended to ally management's interests with those of the shareholders. There will also be a stock-option scheme for management, the details of which have not been finalised yet.

Fig 7 Shareholder structure (2005)



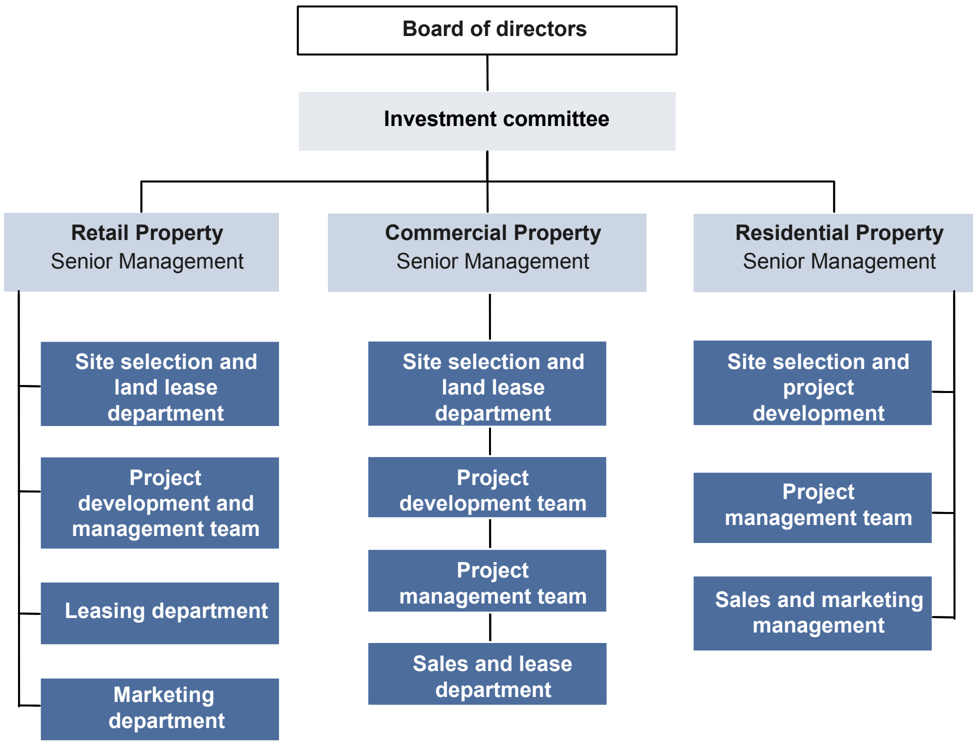
Source: Company data

Corporate structure

There are three property divisions, excluding the fast-food restaurants

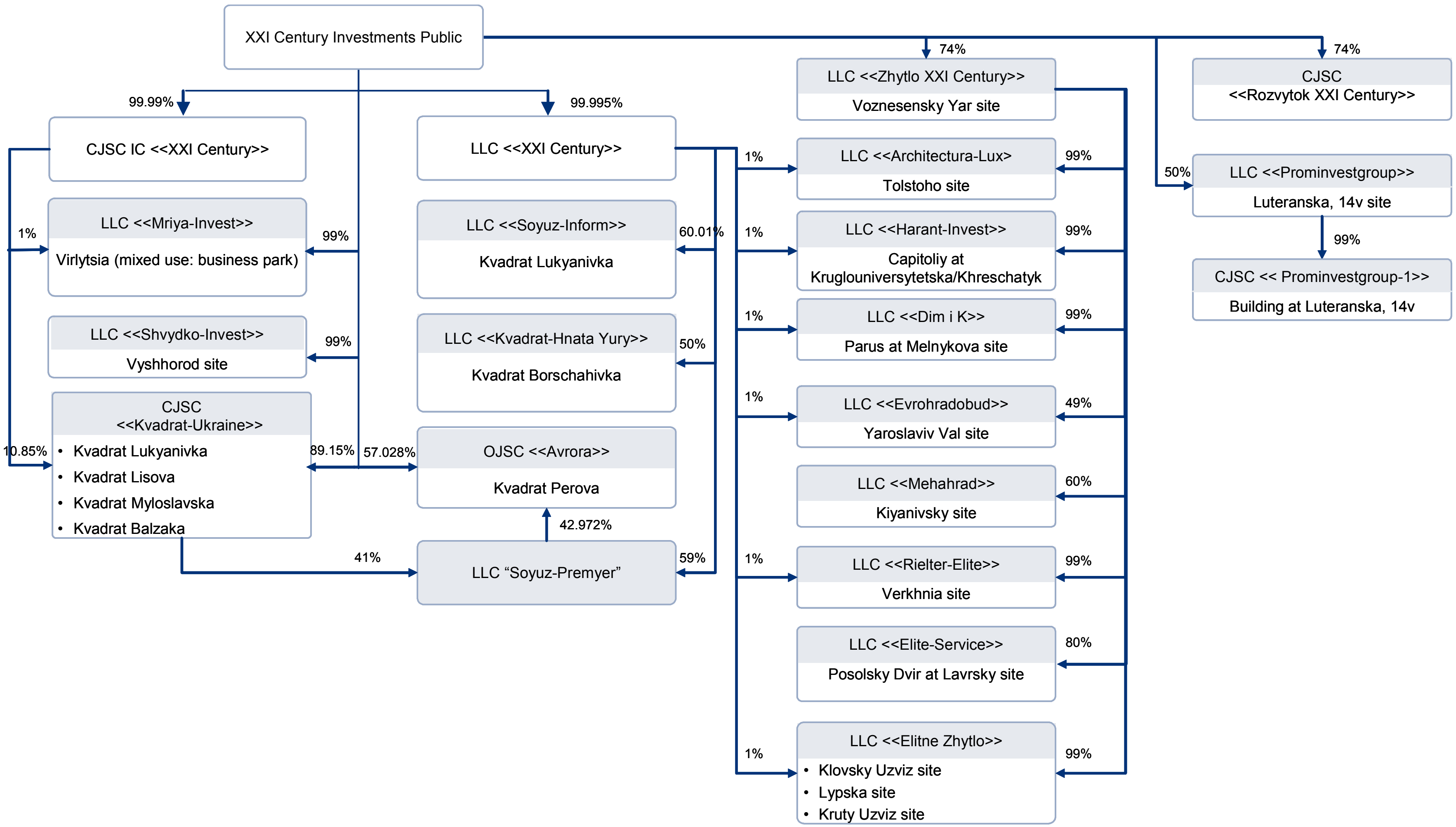
The group currently has three operating segments: the retail property division, Kvadrat Ukraine, which is 100% controlled; the residential development division, which is 74% controlled and the commercial property division, which is 100% owned. Until the end of 2005, the group also owned CJSC Shvydko Ukraine, which runs a chain of fast-service restaurants specialising in Ukrainian cuisine. The Shvydko chain has been operating in Kyiv since 2000 and currently has 11 outlets, as well as its own central production facility. The US-based Western NIS Enterprise Fund has been a partner and 49% shareholder since 2003. The disposal of the chain was agreed before year end.

Fig 8 Organisational chart



Source: Company data

Fig 9 Group structure as at November 2005



Source: Company data

Employees

At the end of June 2005 the company had 159 employees, including personnel at the three underground shopping centres not then divested. This is a 25% increase from year-end 2004, mainly due to higher staffing in retail, with a few extra staff in management and residential.

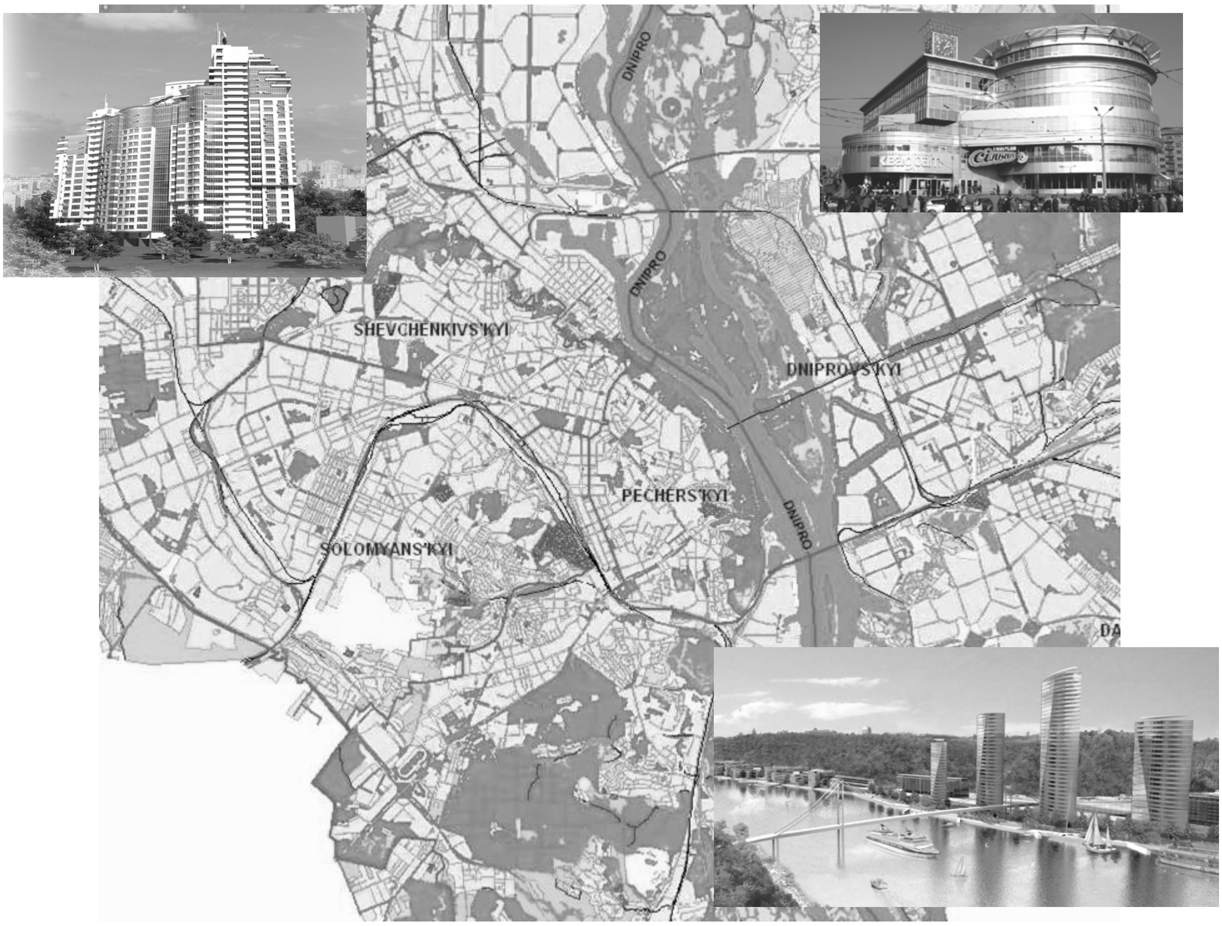
Fig 10 Employees

	2003	2004	1H05
Head office management	3	13	19
Retail	76	86	105
Residential	23	25	32
Commercial		3	3
Total	**102**	**127**	**159**

Source: Company data

Portfolio

Fig 11 XXI Century real-estate portfolio



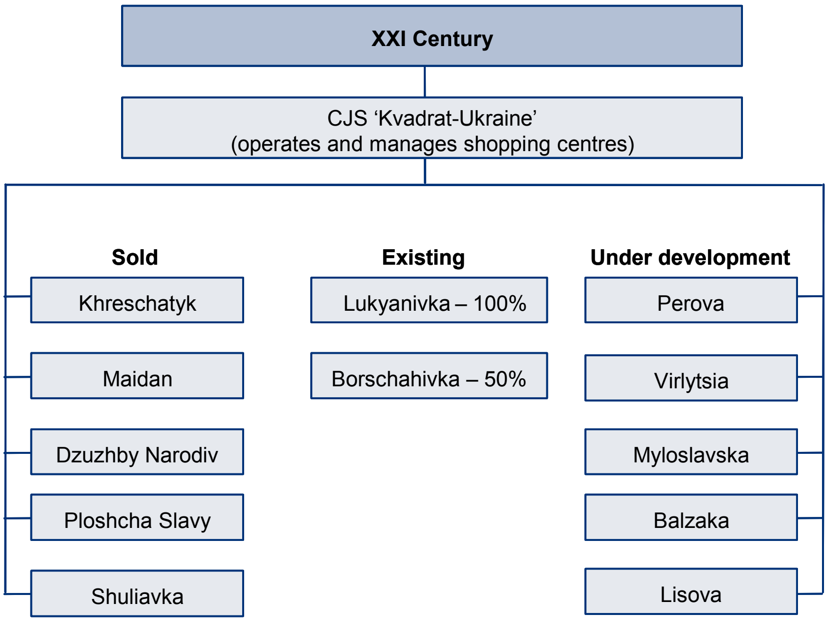
Source: Company data

Kvadrat retail chain

Five new Kvadrat centres being developed

Kvadrat Ukraine is the leading domestic developer and operator of shopping centres. The company managed a chain of five shopping centres with a total floor plate of 32,820m^2 under the *Kvadrat* brand name. It has recently sold three of these centres with a floor plate of 8,400m^2. Within the next few years, the company intends to expand the network in Kyiv by adding another five shopping centres with a total floor plate of 205,000m^2. Kvadrat shopping centres are targeted at the middle class and provide a variety of goods and services intended to satisfy family needs. More than 55,000 shoppers visit the Kvadrat chain each day (including the three divested) and the Kvadrat brand name is recognised by 85% of Kyiv residents, according to a marketing study by the TNS Group, making Kvadrat the most widely known and popular shopping centre chain among residents and visitors in Kyiv and the capital region.

Fig 12 Segment structure



Source: Company data

XXI Century the first to develop underground shopping centres

The first Kvadrat shopping centre was opened in 1999 on Khreschatyk in the heart of Kyiv. Since then the company has developed and sold five underground Kvadrat centres in Kyiv with a total floor plate of 9,198m^2. XXI Century was the first company to develop underground shopping centres in Kyiv, generating goodwill from the city government as a result, which stands the company in good stead when seeking further planning approvals. The company now manages another two above-ground Kvadrat shopping centres with total floor plate of 24,400m^2. Over 26,000 visitors and shoppers pass through the existing centres every day.

Fig 13 Existing Kvadrat shopping centres

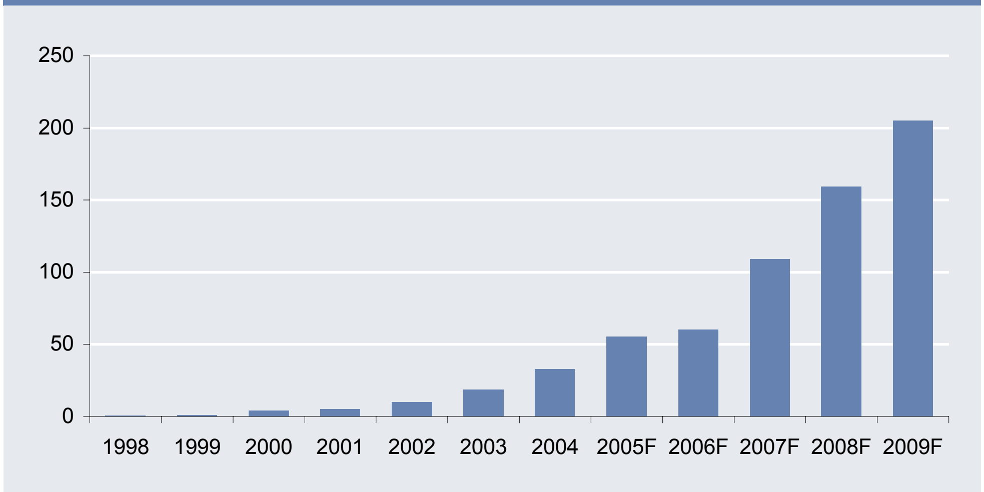
	Lukyanivka	Borschahivka	Total
Size of land plot (hectares)	0.23	1.14	1.37
Total area (m^2)	9,140	15,250	24,390
Retail area (m^2)	6,160	11,820	17,980
Annual rental rate (US$/m^2) net of VAT	430	250	312
Monthly rental rate (US$/m^2) net of VAT	35	21	26
Occupancy rate (%)	100	100	100
Average daily footfall	16,000	10,000	26,000
Anchor tenants	Silpo, Antoshka, Kosmo, Multi	Silpo, Drogerie Centre, Multi	
Food court	Shvydko	Shvydko, Zhar Ptitsia	
Parking spaces	90	200	290
Shareholding (%)	100	50	

Source: Company data

Existing leasable area is 18,000m²

The existing Kvadrat shopping centres have a 100% occupancy rate and, in 2004, generated US$2.6m of revenues. Gross profits in 2004 were US$2m, which implies a margin of almost 78% on turnover. The total lease area is 18,000m^2 with 290 parking spaces and the average footfall is over 26,000 a day. Current monthly rental rates average US$26 per m^2 per month, net of VAT of 20%, services and utilities. Leases are for two to three years for major tenants and are indexed annually. XXI Century has a 67% stake in Lukyanivka and 50% stake in Borschahivka, but is in the process of buying out the minorities, as the partners do not share the vision of management and are less favourable to leveraging up the existing assets for growth. Over the next three years the company plans to expand the Kvadrat network by developing another five shopping centres, thereby expanding the floor plate to 205,000m^2.

Fig 14 Total floor plate of Kvadrat chain (000m^2)



Source: Company data

Remaining three underground centres recently sold

Having sold two Kvadrat shopping centres previously, a further three underground centres have recently been disposed for a cash consideration of US$14m. The centres had a combined gross letting area of 6,651m^2, with average daily footfall of 32,500 and generated over US$3m of revenue. The average monthly rental rate was thus US$47/$m^2$ including VAT (US$39/$m^2$ excluding VAT) last year. The sale price of US$14m allows us to calculate the exit yield for the properties, which averaged over 20%. This is significantly higher than would be expected from larger and more central centres, due to the high occupancy rate, the waiting list of tenants for any vacancies that arise and the high rentals paid by the smaller stallholders. XXI Century did not have complete control of all these sites, so the cash inflow to the company was US$10.6m and gave it a profit of US$8.8m over the development cost.

Fig 15 Underground Kvadrat shopping centres sold in 2005

	Ploscha Slavy	Druzhby Naordiv	Shulyavka	Total
Total area (m^2)	2,717	4,829	890	**8,436**
Retail area (m^2)	2,266	3,700	685	**6,651**
Annual rental rate (US$/$m^2$)	440	500	410	**456**
Monthly rental rate (US$/$m^2$)	37	42	34	**38**
Average daily footfall	14,500	15,000	3,000	**32,500**
Cost of development (US$m)	1.7	2.9	0.6	**5.2**
Total cost/m^2 (US$)	626	601	674	**616**
Exit price (US$m)	6.3	6.5	1.2	**14.0**
Profit on sale (US$m)	4.6	3.6	0.6	**8.8**
Stake (%)	79	39	54	**76**
Cash proceeds (US$m)	4.9	5.0	0.6	**10.6**

Source: Company data, ING estimates

Expansion targeted in residential areas

The Kvadrat shopping centre format follows a hypermarket-gallery combination, which replicates developments in other CEE countries. As well as an anchor hypermarket tenant, there is a gallery of smaller shops and boutiques, with entertainment facilities and a food court. Research from both the company and the consultants, Roland Berger, shows that 'bedroom communities' in the suburbs of the city are the locations with the greatest potential for new retail centres. This is due to an obvious shortage of modern retail outlets and unsatisfied current demand for convenience goods in those areas.

Customers require everything to be in one place

As the strategy is market driven, the company has taken polls of shopping centre visitors, which indicate that they expect everything to be available in one place, from the hypermarket to convenience goods, children's toys, shoes and clothing, home appliances, entertainment facilities and a food court. The strategy is driven by four factors: location, design, proposed goods and services, and price level. Location needs to be a residential area on a site of over 2.5 hectares close to major traffic hubs and subway stations. Design requires a total area of 40-60,000m^2 on up to two levels and with 500-1,200 parking spaces. The services required are a hypermarket as an anchor tenant, with brand-name shops that cover all the daily needs of all members of the family. Pricing should be targeted at the low to middle income classes.

Fig 16 New Kvadrat shopping centres

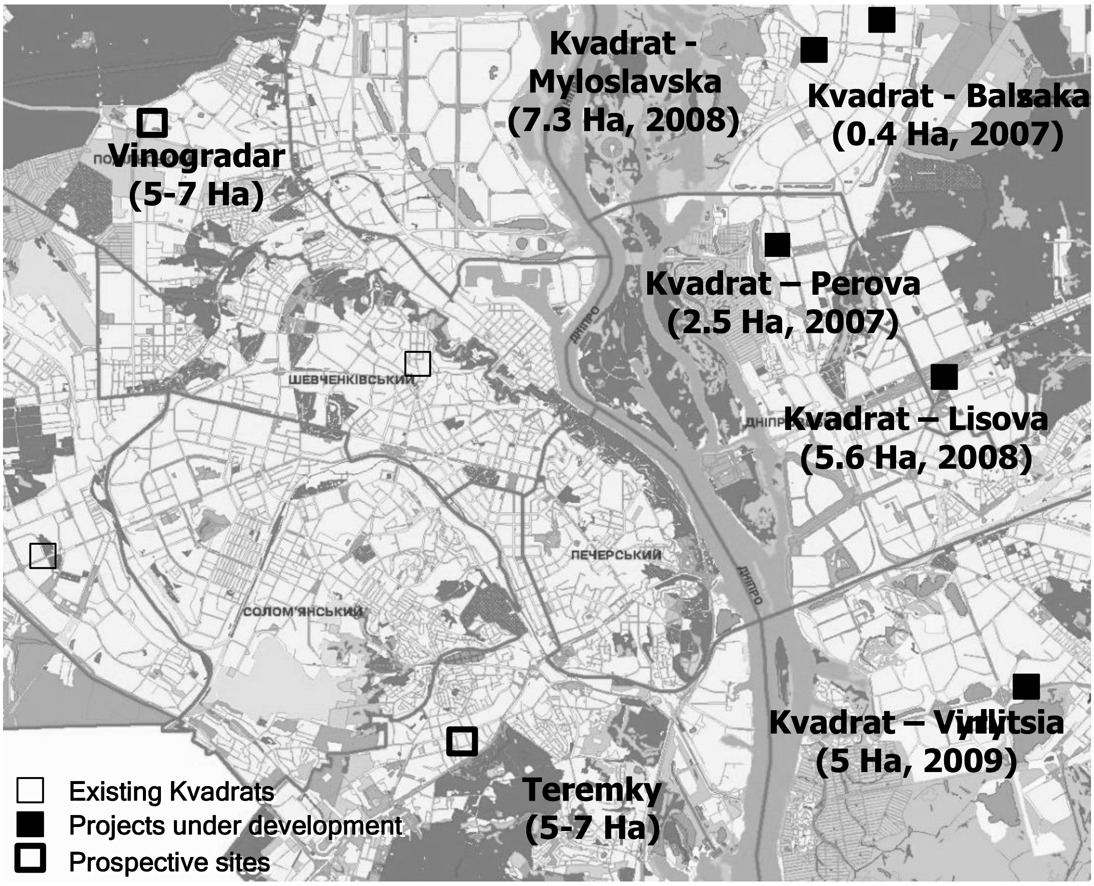
	Perova	Virlytsia	Myloslavska	Balzaka	Lisova
Size of land plot (hectares)	2.5	5.0	7.3	0.4	5.6
Total area (m^2)	40,900	60,000	50,000	5,000	49,000
Retail area (m^2)	18,080	40,000	32,500	3,400	33,450
Catchment area population	100,000	260,000	300,000	300,000	260,000
Parking spaces	400	1,200	1,000	50	1,000
Delivery	3Q07	4Q09	2Q-4Q08	2Q07	1Q09
Current status	Pre-construction	Design	Design	Design	Design
Preliminary lease agreements (%)	80	20	20	0	15
Shareholding (%)	100	100	100	100	100

Source: Company data

Eightfold increase in floor plate planned in under four years

The five new centres to be developed will add over 200,000m^2 of total area to the existing portfolio and about 127,000m^2 of retail space. They are due to be delivered between 2Q07 and 4Q09. This is an eightfold increase in retail floor plate in under four years. Each centre is located in an area with a total catchment population of more than 1.2m people. Construction has already started at the Perova shopping centre, while the others are in the planning and design stages. The site leases have been granted for between five and 25 years for retail, trade and entertainment purposes, although some require recreation facilities to be developed too. So far, 80% of the space at Perova is subject to preliminary site lease agreements, as is 15% of the floor plate at Lisova. XXI Century intends to maintain a 100% stake in all these developments to enable it to decide on the most appropriate financing arrangement, without the need to take account of minority concerns.

Fig 17 Kvadrat growth strategy until 2010



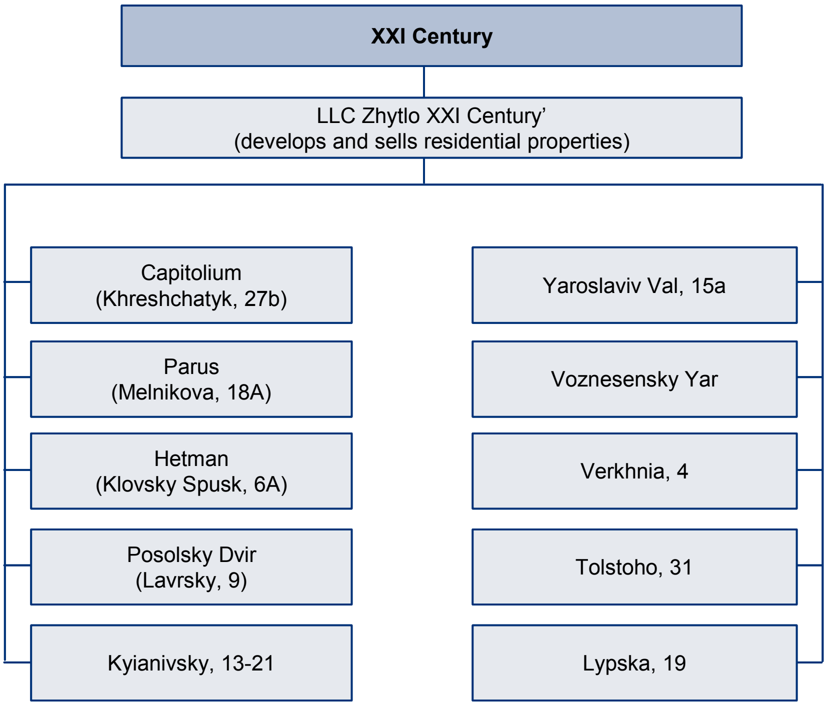
Source: Company data

Zhytlo XXI Century

A project portfolio of 11 sites in Kyiv

Zhytlo XXI Century started operations in 2002 and is set to become the largest division of the group. It is a limited liability company and 74% controlled subsidiary of XXI Century. It designs and develops business class and high-end residential real-estate projects in Kyiv. The management team has so far developed and sold one 11-storey premium class apartment building at Luteranska in downtown Kyiv, containing 42 apartments, known as Triumphal Arch. It is currently developing another two apartment buildings containing 47 and 186 high-end units in the city centre, due for completed in 2006-07. The company has a project portfolio of ten sites in various stages of planning and development throughout Kyiv. Although there is one minority shareholder in the group structure, this is less of a problem in the residential development business, as they are a partner in the business and the land is handed back to the city on completion. However, if the company branches out into property management, it could potentially become an issue.

Fig 18 Segment structure

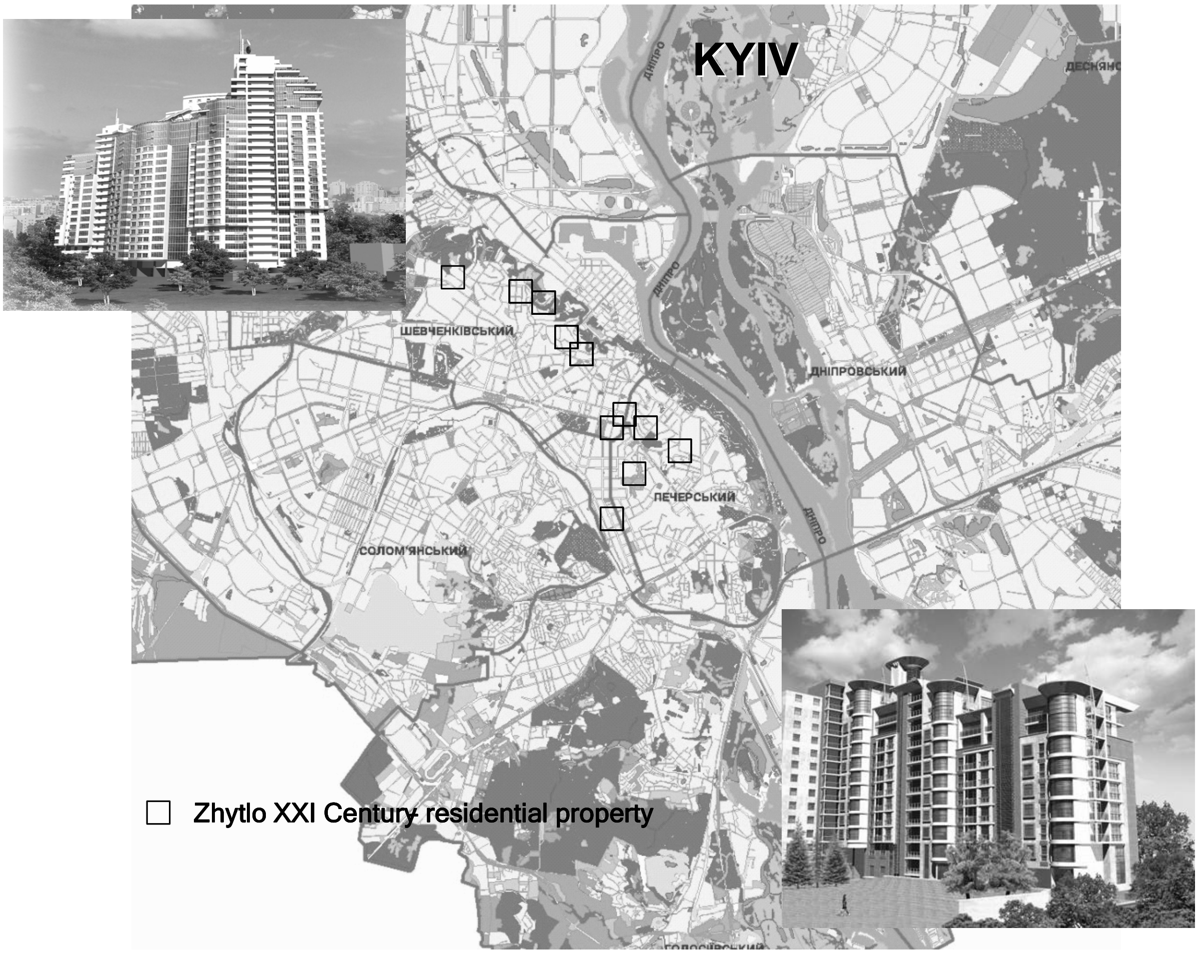


Source: Company data

The City of Kyiv has a ten-year development plan

The City of Kyiv has a plan for redevelopment of the city and land has been zoned for that purpose. However, often the authorities do not build modern amenities or infrastructure for the high-density buildings that are being put up. There are municipal and parliamentary elections planned for 31 May 2006, which could lead to a new mayor being elected, so views on rezoning could change in 2Q06. The plan refers to residential and retail development only and the details are rather sketchy. However, the intention is to see a 58% increase in residential space between 2001 and 2020 to 70.7m m^2.

Fig 19 Zhytlo XXI Century residential projects



Source: Company data

Current projects could total 400,000m²

The company expects to deliver ten major residential developments over the next four years, with a total building area of nearly 400,000m^2. The land plots acquired to deliver these projects total 120,000m^2 in the centre of Kyiv. We have given a couple of examples in Figure 19 of the projects to be delivered in 2006-7, which are currently under construction, while the others are still in the design or planning phase. Generally, leases are issued by the City of Kyiv for a finite period and for a particular purpose, after which the land reverts to the City. Also, the City of Kyiv Administration tends to sign an investment agreement entitling it to a portion of the development, usually 10-15%. However, this is not actually handed over in physical terms, but is paid to the local authorities in cash equivalent terms or can be provided to an equivalent value in a different location.

Capitolium is already 74% sold

Capitolium is close to completion and 74% of the 47 units have been sold. The projected development cost is US$13.4m, which equates to US$922/m^2 of total building area. This is around 10% higher than for Luteranska. However, the company expects to generate significantly more revenue from the project, due to a higher average sales price of nearly US$2,400/m^2 of residential area. As a result, total revenue forecast is US$27.5m and the profit on the development is projected to be over US$14m. The land lease agreement was issued by the City of Kyiv on 5 April 2004 for two and a half years and thus expires on 5 October 2006. Although this is before the projected completion date of December 2006 we assume it will be extended. The investment agreement entitles Kyiv City to 15% of the saleable area.

Fig 20 Zhytlo development projects

	Luteranska	Capitolium	Parus
Total site area (m^2)	3,800	2,354	4,376
Total building area (m^2)	11,000	14,528	43,152
Total residential area		11,598	28,954
Completion date	2Q05	2006	2007
Percentage sold (February 2005) (%)	100	74	11
Current status	Completed and sold	Construction	Construction
Shareholding (%)		74.3	74.3
Project cost (US$m)	9.0	13.4	31.2
Sale proceeds (US$m)	17.2	27.5	38.4
Profit (US$m)	8.2	14.3	7.2
Cost/m^2	**818**	**922**	**723**
Sales price (US$/$m^2$)	**1,564**	**2,380**	**1,326**

Source: Company data, ING estimates

Parus is a much bigger project, with 29,000m² of residential space

The Parus project is also under construction, although at an earlier stage, as it is due for completion in 2007 and thus only 11% of the property has been sold so far. This is a much bigger project, with a total building area of 43,000m^2 and a residential area of nearly 29,000m^2. The cost of development is forecast to be lower at just US$723/$m^2$ of building area, or US$31m. However, the average selling price is also lower at approximately US$1,300/$m^2$, giving a total revenue projection of US$38m and a profit of US$7.2m. The lease stipulates that 10% of the space should be given back to the City of Kyiv, but at a lower cost location.

Project costs will be partly funded by pre-sales

Figure 20 gives a breakdown of the total project portfolio, including Luteranksa, Capitolium and Parus. The total building area of the new projects, now that Luteranska has been completed, is 392,000m^2 and the total residential area is 285,000m^2. However, the project cost is US$349m or US$865/m^2 of building area, which will require financing, partly from pre-sales and partly from company funds. The company is projecting total sale proceeds of US$559m at an average selling price of nearly US$2,000/$m^2$ of residential area.

Fig 21 Zhytlo projects

	Site area (m^2)	Building area (m^2)	Residential area (m^2)	Completion date	Stake (%)	Project cost (US$m)	Sale proceeds (US$m)	Cost/m^2 (US$)	Sales price/m^2 (US$)
Luteranska	3,800	11,000		2Q05	0	9.0	17.2	818	1,564
Capitolium	2,354	14,528	11,598	2006	100	13.4	27.6	922	2,380
Parus	4,376	43,152	28,954	2007	100	31.2	38.4	723	1,326
Hetman	1,848	24,990	17,993	2007	100	22.2	33.2	888	1,845
Posolsky Dvir	8,325	25,000	17,500	2008	66	30.0	52.5	1,200	3,000
Kyianivsky	55,808	70,000	52,500	2007	60	70.0	115.5	1,000	2,200
Yaroslaviv Val	5,031	29,500	22,215	2008	25	29.6	45.6	1,003	2,053
Voznesensky Yar	34,000	100,000	75,000	2009	100	89.0	120	890	1,600
Verkhnia	3,000	40,000	28,000	2008	100	32.8	56	820	2,000
Tolstoho	2,921	40,000	28,000	2008	100	37.2	61.6	930	2,200
Lypska	1,800	5,100	3,570	2007	100	4.8	8.9	941	2,493
Total	**123,263**	**403,270**	**285,330**			**360.2**	**559.3**	**916**	**1,976**

Source: Company data, ING estimates

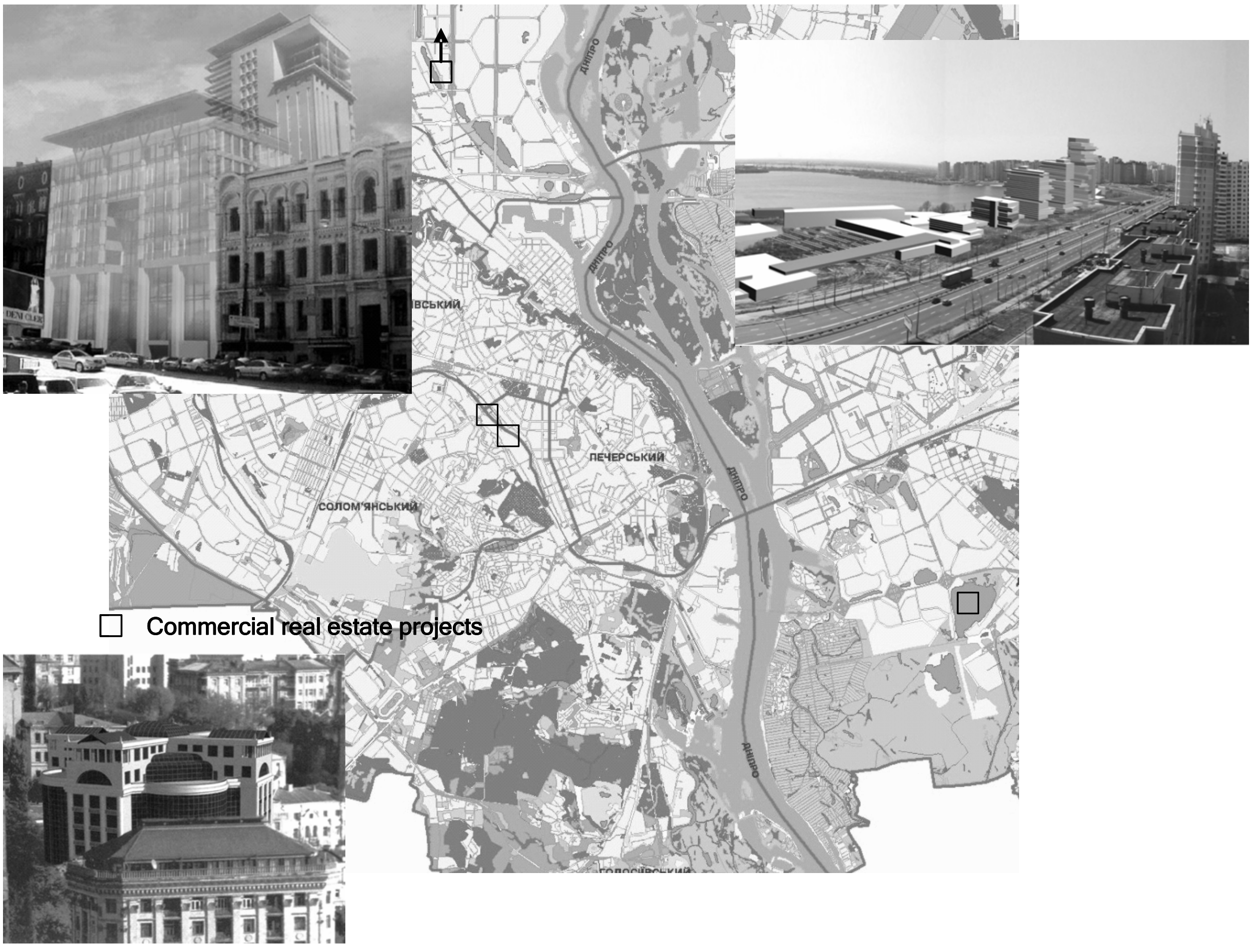
New projects

Commercial real estate

Some projects will be developed with partners

Commercial real estate is a new segment for the company. So far it has acquired four sites in Kyiv and the capital region for the development of four specific projects – a four-star hotel at Luteranska, an office centre at Kruty Uzviz, a business park at Virlytsia, and a warehouse and logistic centre at Vyshhorod. Some of these sites may be developed by the company alone, others will be built in conjunction with strategic partners. As this is a new area there will be quite a steep learning curve for management, so it is actively looking for partners that can bring deeper experience or cheaper financing, in the absence of a properly functioning capital market. The focus will be on office centres, hotels, warehouses and mixed use complexes.

Fig 22 Commercial real-estate division sites



Source: Company data

Virlytsia

Project to be developed in phases

The biggest project is likely to be the Virlytsia mixed-use complex on a 20-hectare site close to the Kharkivska Metro station. This is intended to comprise an office complex with almost 130,000m^2 of rentable area, a DIY centre, restaurants and a convenience store, with 1,999 parking spaces. There is the possibility of a three-star hotel as well. The location has a potential catchment area of 260,000 people, so should produce significant footfall, in addition to the office workers at the site. Completion is expected in phases between 2007 and 2012 and the project is currently in concept development.

As this is such a large project, XXI Century expects to attract partners to assist with financing and development.

Fig 23 Virlytsia mixed-use project

	Offices	Parking spaces	DIY	Restaurants	Convenience store
Total floor area (m^2)	112,440	1,999	10,000	1,700	2,125
Gross lease area (m^2)	106,818	1,800	8,000	1,445	1,700
Occupancy rate 2007F (%)	95	95	95	95	95
Catchment area population*	260,000				
Completion date	2007-12				
Status	Concept	Development			
Shareholding** (%)	100	100	100	100	100

*Potential, **Under review

Source: Company data

Luteranska

Acute shortage of good quality hotels

The company is planning a four-star hotel in the centre of Kyiv near the Capitolium project. It is to be a 350-room hotel with total floor space of 25,000m^2. Construction is expected to start next year, with completion in 2007. The development cost is projected at US$48.5m and XXI Century is thus expected to seek a joint-venture partner to develop the project. If possible, management would prefer a hotel operator to put in equity as well and could look to sell out in the medium term. Again the company is happy to give up a controlling stake to mitigate the risk of the project.

Fig 24 Four-star Hotel Luteranska

Size of land plot (m^2)	3,600
Total floor space (m^2)	25,000
Rooms	350
Construction start	2006
Occupancy 2008F (%)	65
Completion date	2008
Shareholding (%)	50

Source: Company data

Vyshhorod

Severe lack of logistics facilities in Kyiv

Given the lack of warehousing and logistics facilities in Kyiv and the surrounding area, this is another area where XXI Century sees considerable opportunity. The Vyshhorod logistics centre will be located in the outskirts of Kyiv on a 20-hectare site. It is expected to have an initial gross leasable area of between 20,000m^2 and 80,000m^2 in a three-phase development. The land is in the process of being rezoned for the project and the site has infrastructure and amenities, including water and power. Completion of the first phase is forecast for 2007 but the venture is still at the concept design stage. The company is likely to keep 99% control of this asset, given its potential returns.

Fig 25 Vyshhorod logistics centre

Total area (ha)	20
Gross lease area (m^2)	20-80,000
Occupancy 2008F (%)	90
Phase 1 completion date	2007
Status	Concept development
Shareholding (%)	99

Source: Company data

Kruty Uzviz

Land lease still pending

Finally, in the centre of Kyiv the company is looking to redevelop Class A offices at Kruty Uzviz, which will have a total floor area of 15,000m^2 and a gross lease area of 11,000m^2, with parking of 137 spaces. Completion is expected in 2008, although the land lease agreement is still pending, as a XXI Century subsidiary is intending to swap 2,000m^2 of space at another building for the right to develop at Kruty Uzviz Street. Again, management will look for a partner for this project, to mitigate risk and give access to better funding terms, reducing the shareholding to 74%. However, the level of shareholding is undecided so far. Total development costs are forecast at US$11m or US$1,000/m^2 and the city is entitled to 10% of the equivalent area on completion.

Fig 26 Kruty Uzviz office centre

Total floor area (m^2)	15,000
Gross lease area (m^2)	11,000
Parking spaces	137
Occupancy 2008F (%)	90
Completion date	2008
Status	Land lease pending
Shareholding (%)	74.3

Source: Company data

Strategy

To be leading developer and manager in Ukraine

The key long-term objective is to remain one of the leading real-estate development, management and investment companies in Ukraine. Along the way, the aim is to use selective development of good projects to expand its reputation and hopefully secure high returns on investment. The chief strategic task of XXI Century management is thus to increase the value of its property portfolio. This should be achievable by leveraging its experience in the Kyiv market and applying western expertise and outsourcing concepts to the local market. The company conducts a thorough analysis of investment projects, selects qualified personnel and controls the projects, which are developed by group companies. The strategies for each business segment are as follows:

Retail centres

Focus on large format retail sites

Focus on developing existing land sites into large format shopping centres of 40,000-60,000m^2, with parking, hypermarket and leisure facilities, including cinemas and food courts. Located in high-density residential areas on the perimeter of Kyiv, near transport hubs, the stores will aim to cater for the everyday family needs of low and middle income groups, which are the fastest growing segment of the population.

Residential apartments

Company may offer mortgage financing in future

Develop high-end apartments in desirable locations in central Kyiv, especially near historic or cultural sites. Exploit the reputation for building good value quality apartments to begin satisfying consumer demand in this segment. Continue to pre-sell the units before completion, due to strong demand and good locations. In future the company may offer mortgage financing to widen the appeal of the developments and sell fitted out apartments, rather than shell and core. Eventually they may offer maintenance services as well.

Commercial property

Medium to long-term intention is to sell off assets

Develop commercial properties, with strategic partners where appropriate, with a medium to long-term objective to sell them to international institutions, once the rental income has stabilised. Involving financial or strategic partners would provide the technical expertise and financial resources to develop properties.

The divestment strategy is defined at the planning stage of each project. Priority is given to selling group companies to strategic investors or involving financial partners. Provided the Ukrainian stock market continues to develop, there may be an option to sell group companies through the equity market. A holding period of seven to nine years from completion is regarded as the optimal time for divestment.

Building the pipeline, outsourcing and expansion

Focus on investment-grade property

Management intends to continue building a pipeline of land sites for development, as new projects should provide the best returns. The main focus will be on investment-grade properties built to international standards, which are seeing the highest demand. The company will also outsource parts of the development process to optimise management resources and minimise risk. The plan is to use third-party international specialists to advise on various stages of the development process, as requirements converge with western standards. Risk will be reduced further by diversifying the portfolio across the retail, residential and commercial segments.

Expand beyond the capital eventually

Management also intends to look for opportunities beyond the capital and throughout Ukraine. So far, XXI Century group's activities are mainly focused in Kyiv and the capital region since this is the largest real-estate market and the largest consumer market in Ukraine. Kyiv also enjoys the fastest economic growth of any Ukrainian city and its residents have the highest income levels in the country. Therefore, in the short to medium term, XXI Century group's strategy is to grow its core businesses within the capital region and at the same time, identify and initiate real-estate investments in other regional cities, where growth conditions and consumer markets justify investment. Attractive growth opportunities do exist in other markets and the company is currently negotiating a project in Crimea.

Capital structure

Consolidate holdings from JV partners

To optimise the capital structure and consolidate joint-venture partnerships, no longer needed now that financing is more readily available. These partnerships are now being consolidated through negotiated repurchases. In future, partnerships will be with financial or strategic investors instead. The company will also look for equity from financial partners and use internal cash flow to finance new projects.

Competition

Long experience of the market is a key advantage

XXI Century benefits from several key competitive advantages. First, it has extensive property development experience and contacts, as one of the first companies to exploit the opportunity in the local market and with a management team that has worked together since 1999. Developing seven shopping centres and one residential complex has produced significant contacts among developers, contractors, architects and suppliers. It has also generated a close relationship with the Kyiv municipal authorities, which is particularly important in Ukraine, as development is a complicated process involving many approvals from various administrative departments.

First-mover advantage in retail

As the first mover in the shopping centre segment, the company worked closely with the city administration to redevelop downtown Kyiv. This has given the company a well recognised brand name, helping to secure major tenants and attract shoppers. The strength of the working relationship with the authorities helps when Kyiv City Council is allocating land through open tenders, which are judged not just on the value of the offer, but also the bidder's ability to execute a project. Reputation, experience and international contacts all help when bidding and when offered opportunities from private groups with development rights. The company also has low debt levels as expansion has so far been financed through equity. This can quickly be changed through expanding debt financing, giving greater capital flexibility.

Competition is entirely local and very fragmented

Competition in the real-estate market is fragmented among local developers, as there are no national or international rivals. Most competitors do not appear to have a clear strategic focus or direction. In shopping centres, XXI Century competes with Lex Holding, a retail developer, operating under the brand name Karavan, which has a total retail area of 50,000m^2. Delight Ltd operates the Globus retail centre with total area of 38,000m^2 in the centre of Kyiv. The Globus and Karavan centres are popular, but tend to target upper middle class consumers. Metrograd operates an underground shopping centre with 20,000m^2 of space on Tolstoho Square, which has a similar mix of customers to Kvadrat. There are others like Promenada, which compete more directly due to their locations.

Little competition in residential or commercial

In the residential sector competition is limited, but the other developers in the high-end sector are HCM Property Management, TMM, Granit and Zhytlo-Invest. The lack of high-quality office space in Kyiv means there is little competition in this segment and the same is true of the industrial segment.

Fig 27 Competitors

Kyiv	Local
Karavan	Promenada
Globus	Ritm
Metrograd	Dom Mebeli
	Aladdin
Delight Ltd	DaRynok
Foreign brands (franchises only)	Others

Source: Company data

XXI Century 1H05 results

Profits hit by higher costs in retail and restaurant segments

The company reported net profit of US$0.7m in 1H05. This was a 64% fall YoY, mainly owing to increased costs in the retail and restaurant businesses. Turnover was actually 42% higher, on the back of strong increases in sales in both the retail and restaurant operations. The former saw an improvement of 26% to US$1.5m and the latter a gain of 55% to US$2.1m. However, since the end of the interim period, the company has completed the sale of its three underground Kvadrat centres. There was also a much larger contribution from the residential business, which increased from a negligible level to US$0.4m. This was offset, to some extent, by a rise in inter-segment sales, which were eliminated on consolidation.

Fig 28 Consolidated income statement (US$m)

	1H04	1H05	YoY %ch
Revenue	2.40	2.83	42.2
Cost of sales	(0.89)	(1.53)	72.9
Gross profit	**1.51**	**1.30**	**-14.0**
Other operating income	0.07	0.06	-4.4
Distribution costs	(0.91)	(1.29)	42.0
Administrative expenses	(0.80)	(1.03)	28.6
Other operating expenses	(0.23)	(0.06)	-73.5
Profit/(loss) from operations	**(0.37)**	**(1.02)**	**178.6**
Financial income/expense, net	0.07	0.31	326.2
Negative goodwill on consolidation	2.19	1.15	-47.5
Share of income/(loss) from associates	0.00	(0.02)	841.5
Profit/(loss) before tax	**1.89**	**0.41**	**-78.3**
Income tax expense	(0.03)	(0.02)	-38.7
Profit/(loss) after tax	**1.86**	**0.39**	**-79.0**
Minority interest	0.09	0.31	250.4
Net profit from ordinary activities	**1.95**	**0.71**	**-63.8**
Extraordinary items	0.00	0.00	
Net profit/(loss) for the period/year	**1.95**	**0.71**	**-63.8**
Gross margin (%)	63.1	45.9	-27
Operating margin (%)	-15.3	-36.1	136
COGS (%)	36.9	54.1	46
SG&A (%)	71.4	82.1	15
Tax rate (%)	1.7	4.8	182

Source: Company data

Lack of profitability in restaurants reduced group profits

The 73% rise in cost of goods sold was driven by a 98% surge in the retail operations and a 63% increase for the restaurants. As a result, gross profits fell 14% to US$1.3m. However, after sharp rises in distribution and administrative expenses, mainly in the restaurant operations, the company reported an operating loss of US$1m. Fortunately, the restaurant business has been sold as management seeks to focus on property development and management. The restaurant operations diluted this focus and, as they are also loss making, their divestment from the group makes perfect sense.

Retail operations made a small profit

Of the other business segments, the retail operations made a profit of US$1m at the gross level, despite the cost rises, while the residential segment made a small loss. Given that this is a new business currently developing two properties and was only recently consolidated, this is not surprising. This division has the most potential in the group, with ten projects at various stages of development.

Fig 29 Segmental report (US$m)

	1H04	1H05	YoY %ch
Residential business	333	424,704	N/A
Commercial business	1,177,504	1,482,043	25.9
Restaurants	1,336,811	2,072,163	55.0
Other	0	0	
Eliminations	(115,947)	(1,147,188)	889.4
Total revenue	**2,398,702**	**2,831,722**	**18.1**
Residential business	(378,364)	(314,408)	-16.9
Commercial business	246,517	(17,146)	-107.0
Restaurant	(210,881)	(487,731)	131.3
Other	(24,433)	(51,767)	111.9
Eliminations	0	0	
Operating profit	**(367,159)**	**(1,022,881)**	**178.6**

Source: Company data

Goodwill writebacks made the group profitable

Other points of interest on the income statement include goodwill, the tax rate and the minority interests. The group capitalised negative goodwill on consolidation of US$1.1m, which was written off through the income statement in 1H05. This produced a positive amortisation writeback of US$1.15m in 1H05 in addition to the US$2.65m in 2004. There should be no more adjustments of this sort and any positive goodwill emerging in the future will be written off through the balance sheet.

Effective tax rate low for three reasons

The tax rate appears very low at just less than 5% as an effective rate. This is due to three factors. First, the residential business is not subject to tax charges, as property is sold through a Cypriot vehicle. Second, although the corporate tax rate in Ukraine is 25%, in Cyprus it is just 10% and there is a double tax treaty between the two countries. This tax optimisation structure has worked well in the past, as an effective rate of 7% in 2004 testifies, but may not be so efficient in the future. The third reason is the group was loss-making at the operating level in 1H05 and only made a profit after the writeback of negative goodwill.

Minorities are positive due to operating losses

The minority interest looks very high as a proportion of net profit and is also positive, which appears strange at first sight, given the profit after tax of US$0.4m. However, this is explained by the operating loss, which is only converted into a profit by the goodwill writeback. This is an accounting adjustment on consolidation, so minorities have to share in the operating losses of the business.

Balance sheet boosted by consolidation and revaluation

On the balance sheet the key points of interest are the big increases in fixed assets, investment property, reserves and provisions. The rise in tangible fixed assets to US$70.2m from just US$1.5m last year is due to the revaluation of investment property under development, which added US$66m to the balance sheet. This mainly relates to new Kvadrat stores under development. The 150% increase in investment property relates to the revaluation of the retail property portfolio. This added US$16m to the line and further additions increased the level by another US$2.4m.

Revaluations through balance sheet not income statement

The level of reserves jumps dramatically because this line includes the revaluation reserve. Revaluations go directly through the balance sheet, not the income statement, so this line reflects the revaluations of investment property and the property under development. The rise in provisions is also linked to the revaluation process, as it creates a deferred tax liability, which in theory would come due when the property is sold. However, the group does not plan to sell its investment property in the short term and, when it does, it plans to sell the special purpose vehicle that controls the asset, not the revalued asset itself, thereby minimising the tax impact.

Fig 30 Consolidated balance sheet (US$m)

	1H04	1H05	YoY %ch
Assets			
Property, plant and equipment	1.49	70.18	4,619
Intangible assets	0.55	0.57	3
Goodwill on consolidation	0.14	2.82	1,884
Investment in subsidiary undertakings	0.00	0.00	N/A
Investment in associate undertakings	3.72	2.82	N/A
Investment property	12.52	31.24	149
Other financial assets	0.00	0.00	N/A
Deferred tax assets	0.00	0.00	N/A
Long-term receivables	0.00	0.59	N/A
Total non-current assets	**18.42**	**108.22**	**488**
Inventories	1.54	4.59	198
Trade receivables	0.00	0.10	N/A
Available-for-sale investments			
Other current assets	4.92	5.71	16
Cash and cash equivalents	3.49	0.79	-77
Total current assets	**9.95**	**11.19**	**13**
Total assets	**28.37**	**119.42**	**321**
Equity and liabilities			
Equity			
Share capital	0.002	0.002	0
Reserves	0.056	48.289	N/A
Accumulated profits/(losses)	9.764	10.078	3
Equity attributable to equity holders	**9.821**	**58.369**	**494**
Minority interest	8.332	24.706	197
Total equity	**18.153**	**83.075**	**358**
Liabilities			
Non-current liabilities			
Long-term debt	3.282	4.948	51
Provisions	0.000	20.531	N/A
Total non-current liabilities	**3.282**	**25.478**	676
Current liabilities			
Trade and other payables	6.222	7.417	19
Short-term debt	0.707	3.439	N/A
Income tax payable	0.001	0.007	N/A
Total current liabilities	**6.930**	**10.863**	**57**
Total liabilities	**10.212**	**36.341**	**256**
Total equity and liabilities	**28.365**	**119.416**	**321**
Net debt	(0.500)	(7.601)	1421
Gearing (%)	2.8	9.1	232.3
NAV	0.49	2.22	357.6

Source: Company data

Assumptions and forecasts

Macroeconomic forecasts

GDP growth will continue to be supportive for real estate

Although the economy slowed significantly last year, the macro backdrop is still supportive to the real-estate sector. GDP is forecast to have grown 2.4% last year, which is a sharp slowdown from over 12% in 2004, but is still good considering the upheavals of the past year. It is also enough to continue the growth in demand for real-estate space. Investment is also forecast to slow severely, some of which would affect retail, commercial, industrial and residential property, thereby aggravating the lack of supply. However, we expect wage rates to continue rising and interest rates to carry on falling, which again is likely to further increase demand for all forms of property, but especially residential space.

Growth and investment to recover in 2006-07

Although inflation is expected to average above 13% last year, interest rates did not follow and thus GDP and investment should recover in 2006-07. We forecast growth of 3% this year and 4.5% in 2007, with investment expanding by 1.5% in 2006 and 3.5% in 2007. Similarly, unemployment is projected to continue falling, despite the growth slowdown, so internal demand for property should keep rising.

Currency appreciation to accelerate

Also interesting is the behaviour of the currency, which we anticipate will continue appreciating over the next three years. Indeed, we expect the pace of appreciation to accelerate, from just under 6% last year to over 7% in 2007. This means that even if property values or rental rates remained flat in local terms, which is an unlikely scenario given the level of inflation, they would rise sharply in US dollar terms. Finally, the government's fiscal balance looks set to improve markedly in 2007, especially with recent privatisation receipts, which should provide support to the economy and construction in particular.

Fig 31 Ukraine: Key economic forecasts

	2003	2004	2005F	2006F	2007F
Real GDP (%YoY)	9.6	12.1	2.4	3.0	4.5
Investment (%YoY)	12.2	10.0	0.8	1.5	3.5
Unemployment rate avg (%)	9.1	8.6	8.0	8.0	7.7
Nominal GDP (US$bn)	50.1	65.0	78.8	90.5	107.0
GDP per capita (US$)	1,053	1,376	1,671	1,925	2,276
CPI (average %YoY)	5.2	9.0	13.6	10.3	9.0
Wage rates (%YoY, nominal)	22.8	27.6	35.9	19.0	11.0
Con gov balance (% of GDP)	-0.2	-3.0	-2.0	-2.5	-1.5
3-month rates (T-bill avg %)	6.4	6.5	5.2	6.0	6.5
Exchange rate (Uh/US$) year end	5.3	5.3	5.0	5.0	4.7
Exchange rate (Uh/US$) average	5.3	5.3	5.1	5.0	4.8

Source: ING estimates

Project rollout

Overall, portfolio set to grow 16x to over 300,000m^2

XXI Century is planning a massive expansion of its property portfolio over the next four years from 18,000m^2 to over 300,000m^2. The retail division's leasable area is forecast to grow eightfold from 18,000m^2 to 145,000m^2 by 2008, while the commercial portfolio could exceed 170,000m^2 from scratch. Even the compound growth rate is over 100% for the three years of retail development. Figure 31 lays out the expansion profile for each project. The bulk of completions are in 2008 and thereafter there are no forecasts for this division. Clearly this is unlikely to be the end of the company's development and further expansion of the portfolio could follow.

Fig 32 Commercial project rollout (m^2)

	2004	2005F	2006F	2007F	2008F	2009F
Lukyanivka	6,160	6,160	6,160	6,160	6,160	6,160
Borshchahivka	11,820	11,820	11,820	11,820	11,820	11,820
Perova				18,080	18,080	18,080
Lisova						33,450
Myloslavska					32,500	32,500
Virlytsia						40,000
Balzaka				3,400	3,400	3,400
Retail	**17,980**	**17,980**	**17,980**	**39,460**	**71,960**	**145,410**
Virlytsia Offices				24,996	38,847	56,118
Luteranska					25,000	25,000
Vyshhorod				20,000	50,000	80,000
Kruty Uzviz					11,000	11,000
New commercial				**44,996**	**124,847**	**172,118**
Investment property	**17,980**	**17,980**	**17,980**	**84,456**	**196,807**	**317,528**

Source: Company data

Growth will continue beyond 2009 as Virlytsia and Vyshorod expand

The commercial portfolio is also expected to see rapid growth, although this time from scratch. With completions of 45,000m^2 in 2007 and more than 70,000m^2 in 2008, the company will grow from nothing to over 100,000m^2 in three years. In 2009, a further 47,000m^2 of space would take total leasable area to over 170,000m^2. However, it does not stop there as Virlytsia is not expected to be fully completed until 2012 and we forecast a further 20,000m^2 at Vyshorod in 2010. Eventually, in 2012, total commercial space could exceed 220,000m^2.

Luteranska's lease is still classified as residential

The commercial project rollout is thus substantial, even though there are only four projects. For comparative purposes we have treated Luteranska as a commercial property, rather than as a hotel. In fact, the lease is still classified as for residential purposes, although the company is in the process of getting this changed. Incorporating its total floor space rather than the number of rooms, gives a better feel for the amount of development the company will be undertaking.

Total residential development forecast at 285,000m^2

As well as the commercial and retail expansion there is also the residential build-out, which will see 285,000m^2 of residential area completed over the next four years. The total building area is even larger at 392,000m^2 on a total site area of nearly 120,000m^2. Completions start slowly with Capitolium this year and then accelerate with Parus, Hetman and Lypska in 2007. There are five projects forecast for delivery in 2008, totalling 95,000m^2 and another two in 2009 with total space of 127,000m^2. So far the Triumphal Arch at Luteranska has been completed by the same Zhytlo management team, while Capitolium is 75% sold and near to completion.

Fig 33 Residential project rollout (m²)

	2004	2005F	2006F	2007F	2008F	2009F
Capitolium			11,598			
Parus				28,954		
Hetman				17,993		
Posolsky Dvir					17,500	
Kiyanivsky						52,500
Yaroslaviv Val					22,125	
Voznesensky Yar						75,000
Verkhnya					28,000	
Tolstoho					28,000	
Lypska				3,570		
New residential			**11,598**	**50,517**	**95,625**	**127,500**

Source: Company data

Capex

Residential development is not included in capex

All this development will require huge capital expenditure. However, only the investment property comes under the heading of capex, as the residential property is treated as a current asset, with sales and costs going through the income statement, not the balance sheet. Hence the residential projects do not appear in the capex schedule in Figure 32. This makes even more sense when we consider that, in general, the residential projects are self funded by pre-sales and so do not require any external funding, except for the initial capital outlay on the lease.

Capex is set to accelerate in 2006-07

We are therefore anticipating investment capex for the retail and commercial projects alone. This is forecast to be just US$2.5m in 2005, relating entirely to the Luteranska Hotel project. Project investment accelerates to US$58m in 2006F and US$107m in 2007F, after which it peaks in 2008F at US$130m and then declines as projects are completed. There is also capex for the tangible assets of around US$7m, which relates to land and buildings, machinery, and fixtures and fittings.

Fig 34 Capex profile (US$m)

	2004	2005F	2006F	2007F	2008F	2009F
Perova			(8.1)	(8.1)	0.0	0.0
Lisova			0.0	0.0	(15.0)	(15.0)
Troyeshchnya			0.0	(14.6)	(14.6)	0.0
Virlytsia retail			0.0	0.0	(17.9)	(17.9)
Balsaka			(1.5)	(1.5)	0.0	0.0
New retail			**(9.6)**	**(24.2)**	**(47.5)**	**(32.9)**
Virlytsia Offices				(11.0)	(11.0)	(13.6)
Virlytsia Other			(35.2)	(35.2)	(35.2)	
Luteranska		(2.5)	(1.6)	(21.0)	(27.6)	
Vyshhorod			(8.4)	(8.4)	(8.4)	(8.4)
Kruty Uzviz		(0.01)	(3.4)	(7.61)	0	
New commercial		**(2.5)**	**(48.6)**	**(83.2)**	**(82.2)**	**(22.0)**
Total investment	1.78	**(2.5)**	**(58.2)**	**(107.4)**	**(129.7)**	**(54.9)**
Tangible assets	(5.84)	(6.63)	(7.21)	(7.63)	(8.06)	(8.53)
Total capex	**(4.05)**	**(9.14)**	**(65.44)**	**(115.02)**	**(137.73)**	**(63.40)**

Source: Company data, ING estimates

Forecast assumptions

Kvadrat expansions are one main driver of sales growth

We are projecting a 68% rise in sales in 2005 to US$9m for one main reason. In the past, the majority of Kvadrat revenue was paid into a tax efficient vehicle and not recognised by the group as turnover. This is no longer the case and thus Kvadrat sales are expected to increase substantially from US$2.6m in 2004 to US$6m this year. Thereafter, Kvadrat turnover is projected to increase in line with its expansion profile and an inflation-linked increase in the rental rate/m^2. Therefore, we are looking for a big step-up in turnover in 2007 when Perova and Balsaka are due for delivery and then again in 2008-09 when Myloslavska, Lisova and Virlytsia are expected to be completed.

Residential sales will drive growth from next year

The other main driver of revenue growth in the next few years is likely to be the Zhytlo residential development business. With completions expected from this year onwards, we are forecasting sales to rise from US$28m this year to US$73m in 2007 and US$240m in 2008, before peaking in 2009 at US$270m. Clearly this is only incorporating existing announced projects and further developments are bound to be added to the portfolio over time. The company accounts for all the sales and costs of the residential projects in the year of completion, rather than on a percentage of completion basis.

Luteranska Hotel to contribute from 2008

We are expecting the Luteranska Hotel, commercial premises and logistics centre at Vyshorod to make a contribution from 2008 onwards. The largest of these will be the hotel, which could generate revenue of over US$26m from 2008. The first stage of the Virlytsia project is forecast for completion from 2007, but the contribution will continue to increase year-on-year, as further stages are completed up to 2012.

We thus forecast sales of US$9m for 2005, rising to US$33m in 2006 and US$91m in 2007. Once the residential projects really kick in from 2008, turnover is forecast to surge dramatically to US$289m in 2008 and US$345m in 2009. However, the Shvydko restaurant business will drop out in 2006 as it was divested in 2005.

Fig 35 Revenue model (US$m)

	2004	2005F	2006F	2007F	2008F	2009F
Shvydko	3.1	3.6	0.0	0.0	0.0	0.0
Kvadrat	2.6	6.1	6.6	11.7	16.5	38.0
Zhytlo		0.0	28.6	73.3	240.0	269.5
Commercial real estate		0.0	0.0	0.0	3.7	4.1
Hotel		0.0	0.0	0.0	26.6	27.4
Industrial		0.0	0.0	1.7	4.5	7.6
Virlytsia		0.0	0.0	11.2	18.1	25.0
Eliminations	(0.4)	(0.6)	(2.4)	(6.6)	(20.9)	(25.0)
Total sales	**5.4**	**9.0**	**32.8**	**91.3**	**288.6**	**346.5**

Source: Company data, ING estimates

Operating expenses are also forecast to rise dramatically

Clearly there are counterbalancing costs, which are expected to rise sharply too. We project total operating expenses to rise from less than US$7m in 2004 to US$188m in 2009. The majority of this rise is accounted for by residential project costs, which go through the income statement as cost of goods sold. However, there are also increases at the Kvadrat division as the number of outlets is expanded and elsewhere as the new projects are delivered.

Fig 36 Divisional profit (US$m)

	2004	2005F	2006F	2007F	2008F	2009F
Shvydko	1.6	1.8				
Kvadrat	2.0	4.6	5.0	9.0	12.6	29.1
Zhytlo	(0.7)	0.0	14.9	18.6	96.3	87.6
Commercial real estate					3.6	4.0
Hotel					10.4	10.3
Industrial				1.6	4.3	7.2
Virlytsia				10.8	17.5	24.2
Other	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Gross profit	**2.8**	**6.3**	**19.8**	**40.0**	**144.6**	**162.3**
Retail overhead	(1.9)	(2.6)	(2.8)	(3.0)	(3.1)	(3.3)
Restaurant overhead	(2.2)	(2.1)				
Operating profit	**(1.3)**	**1.7**	**17.0**	**37.0**	**141.5**	**158.9**

Source: Company data, ING estimates

Residential and retail profits are the key drivers in the short term

We forecast operating profit of US$1.7m for 2005F, up from a loss of US$1.3m in 2004, on the back of improved profits at the Kvadrat division. As expansions start to be delivered from 2007, retail profits should see another boost. This year, as the profits from Zhytlo start to hit the income statement, we project a tenfold increase in operating income to US$17m. Thereafter, residential profits should drive growth, especially from 2008, as project completions step up. With Virlytsia and the industrial business starting to contribute from 2007 and the hotel and commercial real estate from 2008, operating income could reach US$141m and US$159m in 2008-09.

Tax

The effective tax rate is expected to remain below 10%

As with all property developers, the company employs various tax optimisation schemes, including being registered in Cyprus. As well as this, the corporate tax rate in Ukraine is low at 25%. As the residential units are sold as bonds, which are capital gains tax exempt in Cyprus, profit on sales is free of tax for the company. The tax payable on rental income from retail and commercial projects, is expected to be approximately 15%, so we forecast an effective tax rate of 7% in 2005 and 4-8% thereafter. With residential making up the bulk of the profits, its tax-exempt status reduces the effective rate.

Financial statements

The company reports under IFRS and its accounts are audited by Baker Tilley Proios.

Fig 37 Income statement (IFRS, US$m)

Year to Dec	2004	2005F	2006F	2007F
Total revenues	5.35	8.98	32.81	91.33
CoGS	1.41	2.63	13.03	51.38
Gross profit	**3.94**	**6.34**	**19.78**	**39.96**
SG&A	4.61	4.65	2.81	2.98
EBITDA	**(0.67)**	**5.06**	**23.59**	**43.80**
Depreciation	0.66	3.37	6.62	6.82
Operating profit	**(1.33)**	**1.70**	**16.97**	**36.98**
Goodwill amortisation	2.65	1.15	0.00	0.00
Associates	(0.12)	(0.20)	(0.72)	(2.01)
EBIT	**1.20**	**2.65**	**16.25**	**34.97**
Interest expense	(0.20)	(0.85)	(3.40)	(6.37)
Financial income	0.00	0.03	6.82	7.68
Foreign exchange	0.00	0.00	0.00	0.00
Other financial gains	0.21	0.00	0.00	0.00
Net financial income (expense)	**0.01**	**(0.81)**	**3.43**	**1.31**
EBT	**1.21**	**1.84**	**19.67**	**36.28**
Net extraordinaries	0.00	0.00	0.00	0.00
Pre-tax profit	**1.21**	**1.84**	**19.67**	**36.28**
Taxes	0.09	0.13	0.83	2.95
Profit after tax	**1.12**	**1.70**	**18.84**	**33.33**
Minorities	0.43	0.31	0.00	0.00
Attributable profit	**1.56**	**2.02**	**18.84**	**33.33**
Net profit before exceptionals	**1.56**	**2.02**	**18.84**	**33.33**
Y/E Shares in issue	37.34	37.34	37.34	37.34
Average Shares in issue	30.67	37.34	37.34	37.34
Reported EPS	**0.05**	**0.05**	**0.50**	**0.89**
Adjusted EPS	**0.05**	**0.05**	**0.50**	**0.89**
CFPS	**0.07**	**0.14**	**0.68**	**1.08**
Margins & ratios (%)				
Gross	73.6	70.7	60.3	43.7
EBITDA	-12.5	56.4	71.9	48.0
Operating	-24.8	18.9	51.7	40.5
COGS	26.4	29.3	39.7	56.3
SG&A	86.2	51.8	8.6	3.3
Dep'n/PPE	16.4	4.5	8.7	8.9
Tax rate	7.1	7.2	4.2	8.1

Source: Company data, ING estimates

Fig 38 Balance sheet (US$m)

As at 31 Dec	2004	2005F	2006F	2007F
Intangible assets	0.54	0.54	0.54	0.54
Tangible fixed assets	3.35	75.31	75.90	76.70
Investments	2.77	2.77	2.77	2.77
Fixed assets	**19.46**	**118.34**	**185.52**	**305.89**
Stock	2.49	10.98	24.49	51.20
Debtors	0.07	0.13	0.06	0.25
ST investments	3.53	3.53	3.53	3.53
Cash	1.45	160.56	180.74	196.31
Current assets	**7.55**	**175.20**	**208.82**	**251.29**
Other assets	0.00	0.00	0.00	0.00
Total assets	**27.00**	**293.54**	**394.35**	**557.18**
Minorities	8.61	24.67	24.67	24.67
Share capital	0.00	138.74	138.74	138.74
Reserves	(0.09)	52.70	61.06	73.23
P&L reserve	9.37	9.37	11.08	29.92
P&L for the year	0.00	1.70	18.84	33.33
Shareholders' funds	**17.90**	**227.18**	**254.39**	**299.88**
Provisions	0.01	16.30	42.26	138.36
LT debt	2.78	18.39	68.39	88.39
Creditors	4.30	5.43	3.07	4.31
Other liabilities	0.00	22.80	22.80	22.80
ST debt	2.01	3.44	3.44	3.44
Total liabilities	**9.10**	**66.35**	**139.95**	**257.29**
Total capital and liabilities	**27.00**	**293.53**	**394.34**	**557.18**
Net (debt)/cash	(3.3)	138.7	108.9	104.5
Gearing (%)	18.6	-61.1	-42.8	-34.8
NAV	0.48	6.08	6.81	8.03
ROIC (%)	(5.8)	0.7	5.2	9.4

Source: Company data, ING estimates

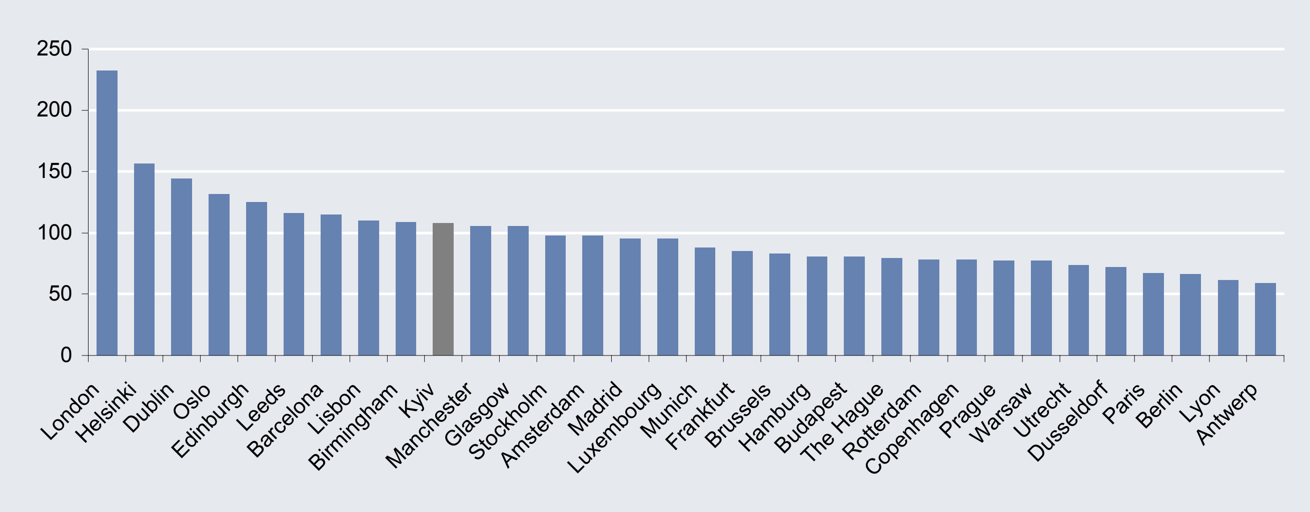
Fig 39 Cash flow (US$m)

Year end Dec	2004	2005F	2006F	2007F
Operating profit	(1.33)	1.70	16.97	36.98
Depreciation	0.66	3.37	6.62	6.82
Other	0.15	(0.20)	(0.72)	(2.01)
Operating cash flow	**(0.52)**	**4.87**	**22.87**	**41.79**
Change in working cap	3.17	8.87	10.16	70.44
Net cash flow	**2.66**	**13.73**	**33.02**	**112.23**
Net interest	(0.20)	(0.81)	3.43	1.31
Dividends	0.00	0.00	0.00	0.00
Tax paid	(0.10)	(0.13)	(0.83)	(2.95)
Servicing costs	**(0.30)**	**(0.94)**	**2.60**	**(1.64)**
Capex	(5.84)	(6.63)	(7.21)	(7.63)
Investments	2.78	0.00	0.00	0.00
Investment property	(1.00)	(2.51)	(58.23)	(107.40)
Investing	**(4.05)**	**(9.14)**	**(65.44)**	**(115.02)**
Free cash flow	**(1.69)**	**3.65**	**(29.82)**	**(4.43)**
New equity	0.00	138.74	0.00	0.00
ST debt	1.91	1.43	0.00	0.00
LT debt	1.05	15.61	50.00	20.00
Other/minorities	0.00	(0.31)	0.00	0.00
Financing	**2.96**	**155.46**	**50.00**	**20.00**
Change in cash	**1.26**	**159.11**	**20.18**	**15.57**
Cash b/f	0.19	1.45	160.56	180.74
Cash c/f	**1.45**	**160.56**	**180.74**	**196.31**

Source: Company data, ING estimates

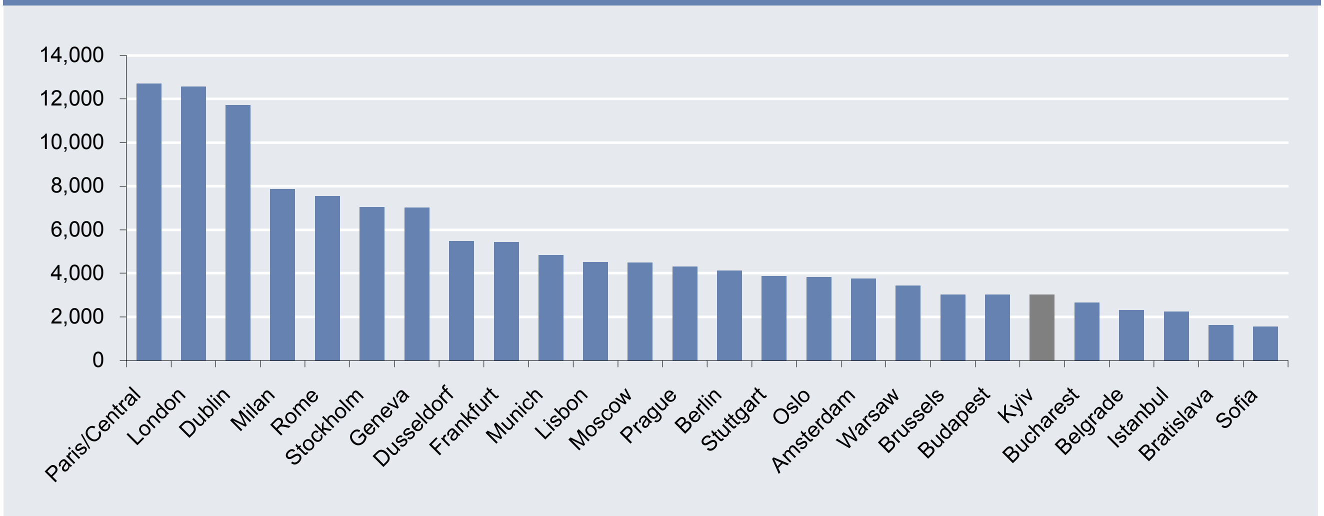
Kyiv real-estate sector snapshot

Fig 40 European prime warehousing rents, 3Q05 (US$/m^2 pa)



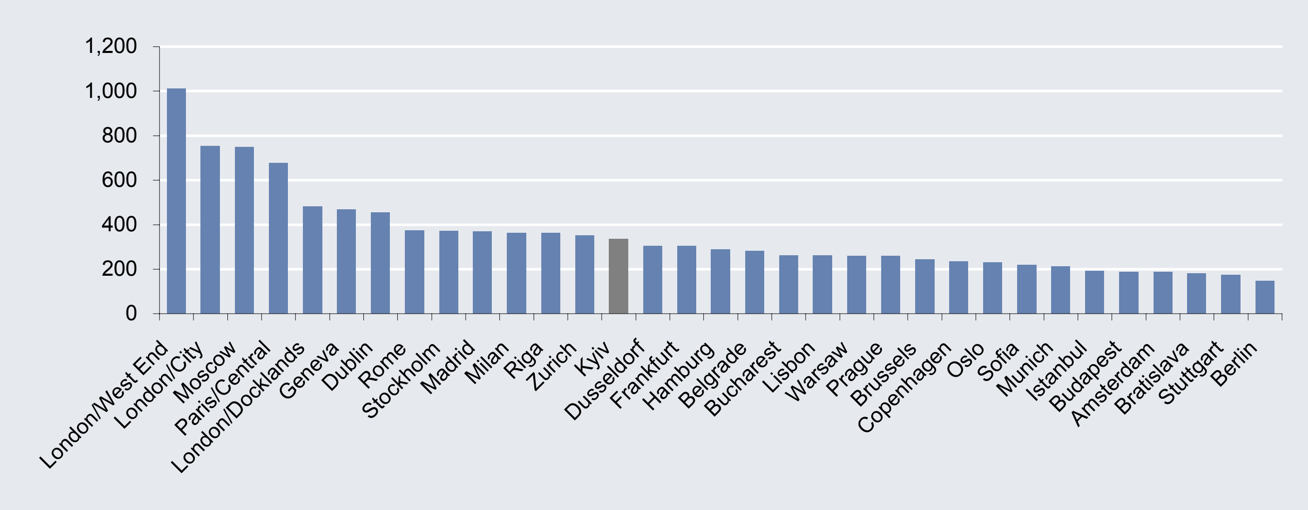
Source: Jones Lang LaSalle, DTZ

Fig 41 European CBD Class A office sales prices (US$/m^2)



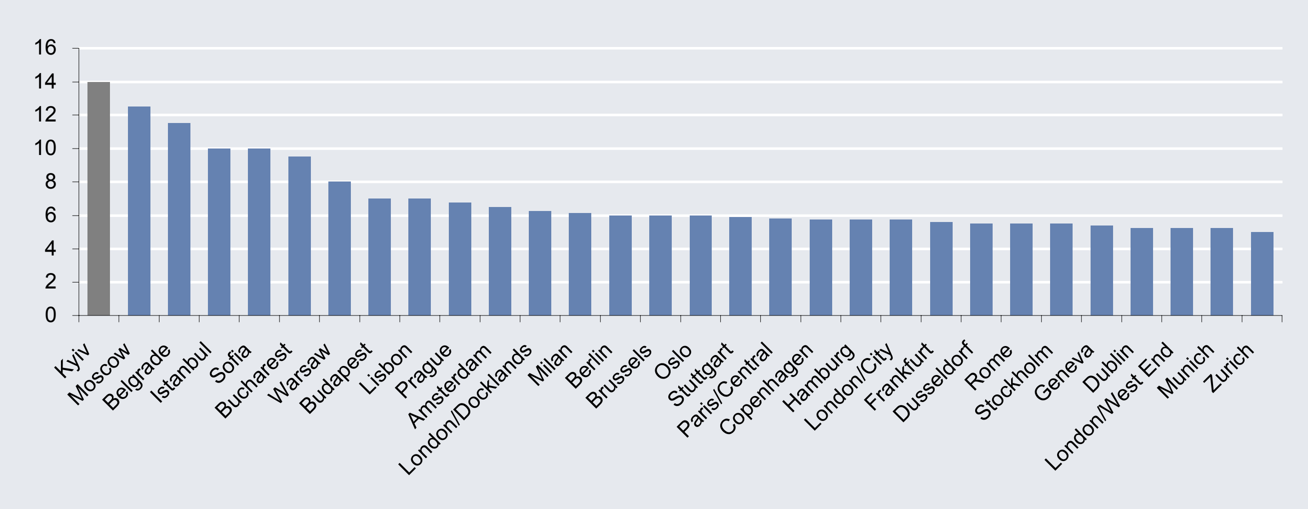
Source: Colliers International

Fig 42 CBD Class A office net rent (US$/m^2)



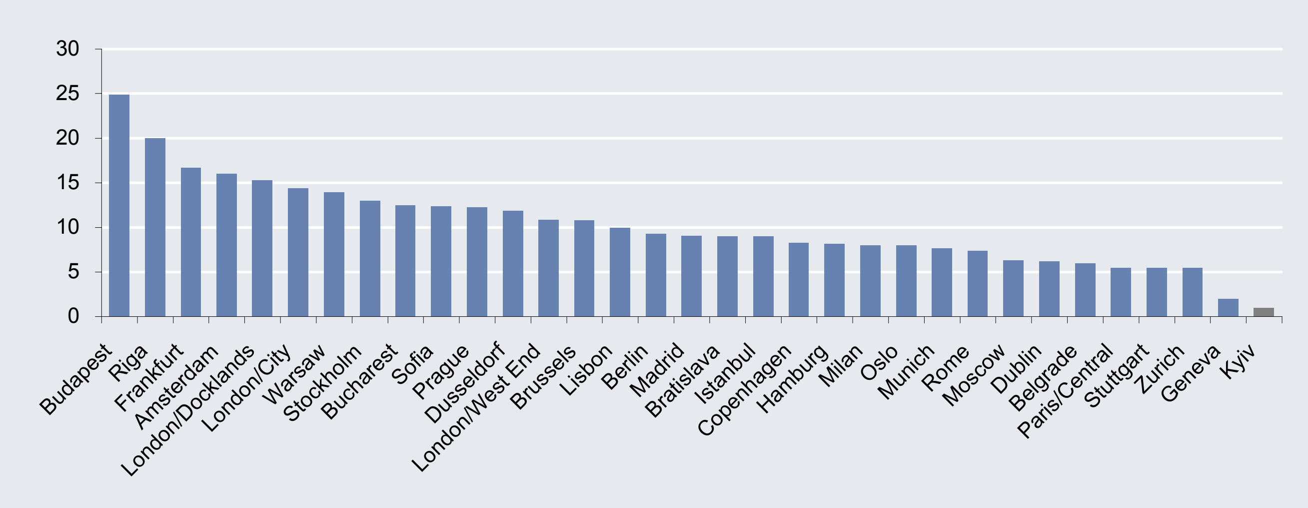
Source: Colliers International

Fig 43 Average prime yield for CBD Class A office (%)



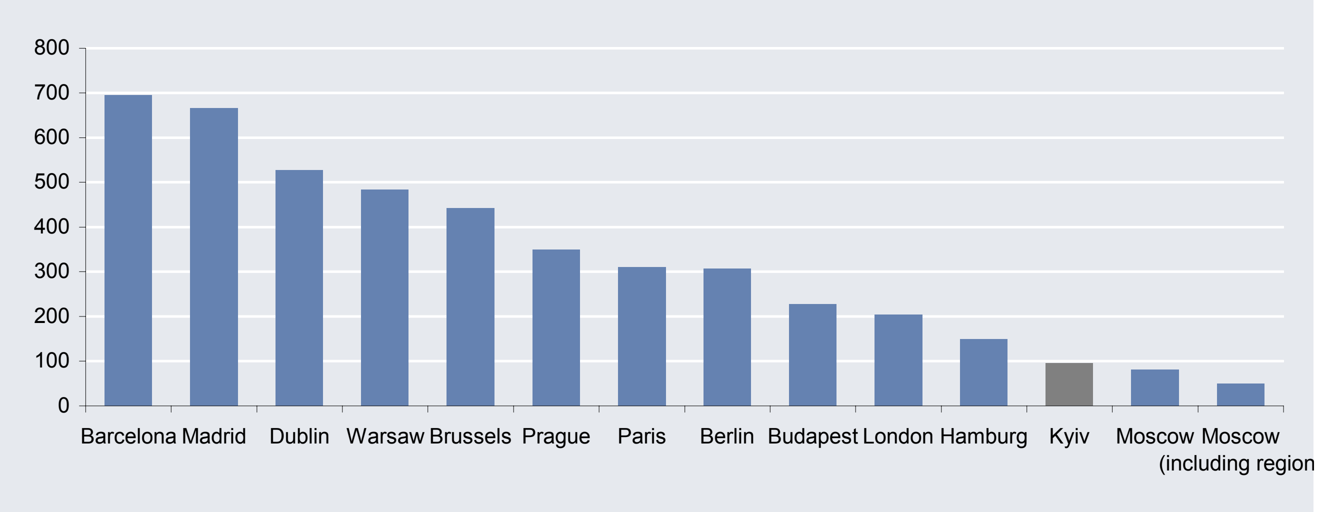
Source: Colliers International

Fig 44 Vacancy rate of CBD office floor space (%)



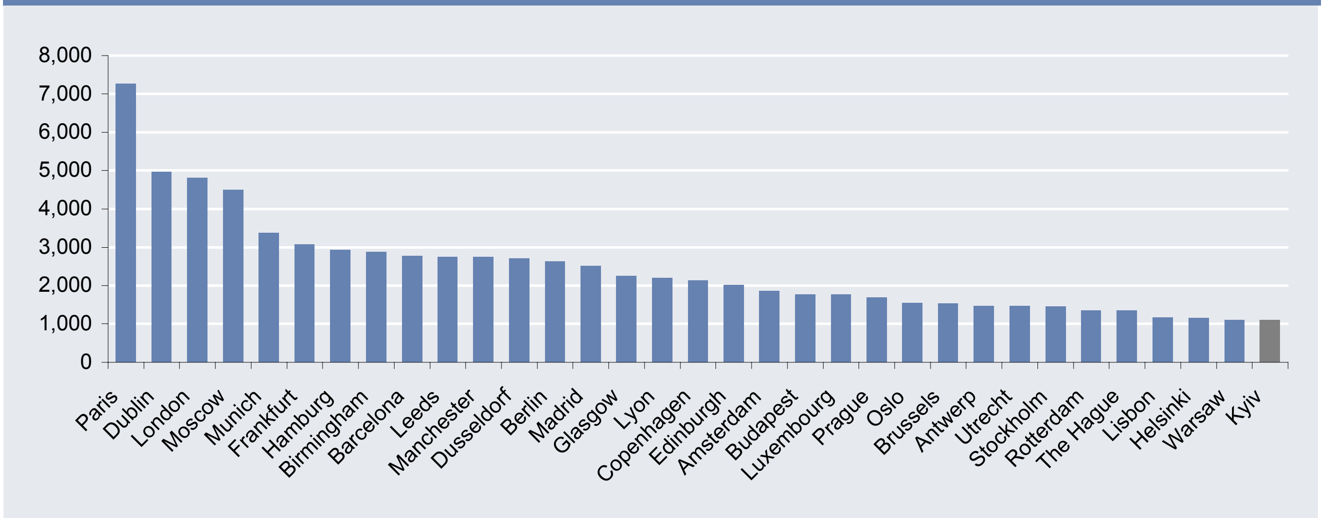
Source: Colliers International

Fig 45 Shopping centre stock (m^2/1,000 people)



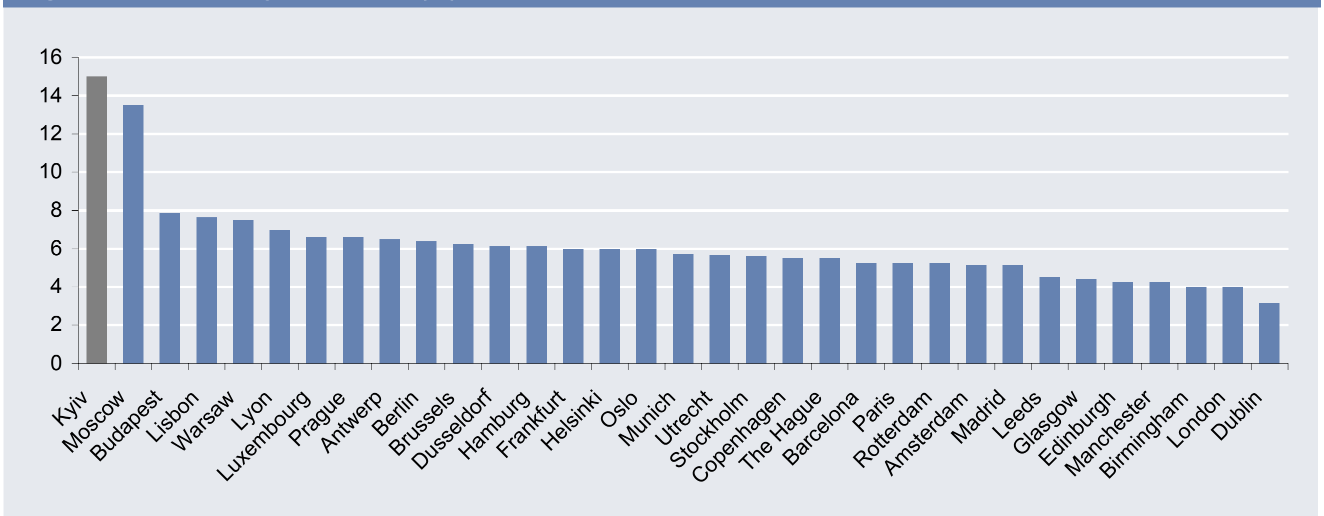
Source: C&W H&B, Company data

Fig 46 Prime retail rents, 3Q05 (US$/$m^2$ pa)



Source: JLL, Company data

Fig 47 Prime retail yields, 3Q05 (%)



Source: JLL, Company data

Land and real-estate legislation in Ukraine

Fig 48 Land and real-estate property legislation of Ukraine

Real-estate ownership	Real-estate mortgages
Real estate can be owned by individuals, legal entities, territorial communities and the state. The law guarantees equal protection of all forms of ownership. Real-estate acquisition by a foreign company is subject to the approval of the local state administration. Land is divided into various categories based on its approved use, such as residential, industrial and agricultural. Foreign companies, as well as wholly or partially foreign-owned Ukrainian companies cannot own agricultural land. If a foreign company purchases land from the state, the company should establish a representative office in Ukraine and obtain permission from the cabinet of ministers of Ukraine. Foreign companies and partially foreign-owned Ukrainian companies can own non-agricultural land, provided that they own the real estate situated on that land. Ukrainian legal entities with 100% foreign ownership (ie, wholly owned subsidiaries) are presently prohibited from holding land in private ownership.	Real-estate mortgages apply to land and other real estate, as well as to unfinished construction. Foreclosure can be contractually regulated. There is a moratorium of unlimited duration on foreclosure of assets of state-owned companies (at least 25% state ownership).
Real-estate transactions	**Taxation**
Real-estate transactions are subject to obligatory notarisation and state registration. Regarding the lease of buildings, facilities and premises, only contracts for 1 year and above are subject to notarisation and state registration. A foreign company can lease out its real estate in Ukraine only via its representative office in Ukraine or via a Ukrainian company. Commercial property acquisitions normally take place via purchase of companies holding title to that property in order to reduce the tax burden.	Owners of land and those with permanent rights to use land must pay a land tax of 1% pa of the normative value of the land. The determination of the normative value of land is carried out by authorised licensing organisations, based on various factors including the location of land and the purpose of its use. At present, there is no real-estate tax in Ukraine. The introduction of a real-estate tax is expected within the next few years. Taxes applying to real-estate operations are: corporate profit tax (25%); withholding tax (15%) applying to the real-estate sale proceeds of a foreign company and the amount paid to a foreign company by its representative office as income from sale/lease of real estate; and VAT (20%). Sale/purchase of real estate is subject to state duty of 1% of the contractual value. Sale/purchase of non-land real estate is also subject to a pension fund duty of 1% of the contractual value. Sale/purchase and lease of land are not subject to VAT.

Land leases
Kyiv City Council allocates property for development in open tenders, with the proceedings of the Kyiv auctions televised. Once a developer is selected, the City negotiates a land lease with the developer. Rents are based on a percentage of the market value of the property and are adjusted annually to reflect new valuations of the properties. A lessee must transfer to Kyiv City Council up to 10% of the developed space upon completion, which the City may either retain for its use or sell to fund infrastructure improvements. According to the Land Lease Law, land lease agreements must be in writing and must contain: 1) the subject matter of the lease, 2) the terms of agreement; 3) the amount of the rent and the terms and means of payment; 4) the purposes of the lease; 5) the terms of maintenance of the leased property; 6) the terms for the transferring of the land plot by the lessor to the lessee; 7) the terms for the returning of the land plot by the lessee to the lessor; 8) a description of all existing restrictions and encumbrances; 9) provisions allocating the risk of damage or loss; and 10) liability. Every land lease agreement is required to be registered with the state authorities. Construction on an allocated land plot can only be carried out after the owner or lessee of the land obtains a construction permit. Construction activities are subject to mandatory licensing. A foreign company seeking to engage in construction work should establish a wholly owned Ukrainian subsidiary or a JV eligible for the receipt of a construction licence. Once construction is completed, the owner of the building may apply for a long-term lease of the underlying land, which is generally freely granted. If the land lease is terminated for some reason, the building owner will in practice have a perpetual right to occupy the land underlying the building.

Source: ING

Management biographies

Lev Partskhaladze – Chairman of the board

Lev Partshaladze, 34, is the founder of XXI Century group. Lev is an elected member of Kyiv City Council and sits on the Committee for Municipal Development and Architecture and the Mayor's Coordinating Council on Entrepreneurship and Business Development. Lev started his entrepreneurial career by opening Kyiv's first fashionable Ukrainian theme restaurant in 1996 and expanded this concept to a chain of highly successful high-end restaurants as well as a chain of fast-food outlets. Lev entered the real-estate market in 1999 by building Ukraine's first underground shopping centre in downtown Kyiv. Lev's business achievements in real estate and in business generally received public recognition in 2004, when he received 'Honorary Economist of Ukraine' and 'Entrepreneur of the Year 2004' awards. Lev is a graduate of Kyiv's European University with a degree in organisational management.

Mykola Yerzhakhovskyy – CEO and member of the board

Mykola Yerzhakhovskyy, 34, holds a degree in Law from Kyiv National Shevchenko University. Prior to joining XXI Century Group in 2002, Mykola was chief legal counsel with Alfa Capital Ukraine, a Ukrainian investment arm of Russia's Alfa Group. Mykola started his career in the financial industry as a senior lawyer with Ukraine's securities market regulator, the Securities and Stock Market Commission of Ukraine.

Taras Kutovyy – CFO and member of the board

Taras Kutovyy, 29, is a graduate of Kyiv National Economics University with a degree in international economics. He also holds an MBA degree from Kyiv's International Management Institute. Prior to joining XXI Century Group in early 2004, Taras was finance director of Soros Foundation's biggest programmes.

Jaroslav Kinach – Member of the board

Jaroslav Kinach, 60, has extensive experience in corporate and international finance gained with Canada's Toronto Dominion Bank, where he worked for 22 years. Jaroslav was EBRD's Ukraine Country Head from 1995 to 1999, and then was Advisor to the Prime Minister of Ukraine until 2003. He holds an MBA degree from the Graduate School of Business, Columbia University in New York City.

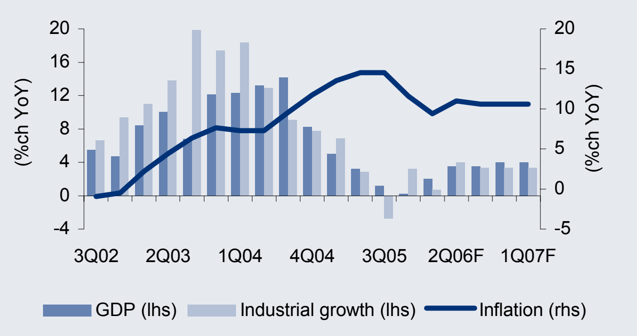
Maxim Belous – Member of the board and head of market research

Maxim, 35, holds an MA degree in international economics from Kyiv National Shevchenko University and a degree in engineering from the Institute of Engineering and Construction. Maxim obtained his first real-estate experience and also learned the western approach to the industry in the Kyiv office of Colliers International where he served in a number of capacities for five years. Maxim is licensed by the State Property Fund to perform appraisals. Overall, Maxim has 13 years of experience in the real-estate industry.

Ukraine: Fundamental drivers

Activity:	= (-)	Fiscal trend:	Neutral (neutral)	Monetary trend:	Looser (tighter)	Liquidity ratio:	76.0 (47.4)	Import cover (mths):	6.5 (5.0)	Political stability:	1.5 (7.0)

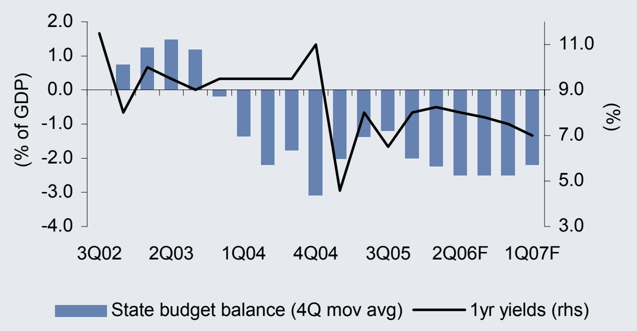
Activity and inflation



March elections – more bad news?

The deteriorating image of Ukraine in 2005 has worsened further since the gas row with Russia and the internal constitutional clashes. The election outcome in March may see Yushchenko's rival, Yanukovich, heading the largest party in parliament, which could make Tymoshenko a queenmaker in between. Much may depend on whether constitutional changes are rejected or accepted in the possible referendum Yuschenko now favours. A Yanukovich government with greater powers would mean Kuchma did win in the end. All other most likely alternatives would be better scenarios, but none would be unequivocally good. Against this backdrop, we accept that there is no chance of currency revaluation in the first half.

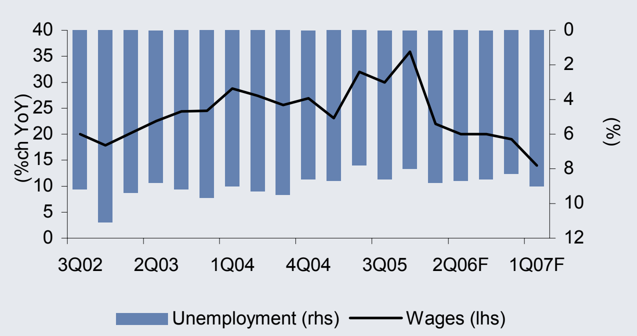
Fiscal stance and yields



Forecasts

	3Q05	4Q05F	1Q06F	2Q06F	3Q06F
GDP (%,YoY)	1.2	0.2	2.0	3.5	3.5
PPI (end quarter, %YoY)	15.1	9.5	7.7	11.7	13.6
CPI (end quarter, %YoY)	13.9	10.3	8.8	11.2	10.6
M3 growth (end Q, %YoY)	31.3	31.0	29.0	27.5	26.0
Trade balance (% of GDP)	-5.4	-3.2	-2.8	-8.6	-6.9
Current account (% of GDP)	0.0	-1.6	2.3	-1.4	-1.3
International res (US$bn)	14.2	19.4	18.0	17.9	18.2
Import cover (months)	5.0	6.5	5.7	5.4	5.4

Employment and earnings



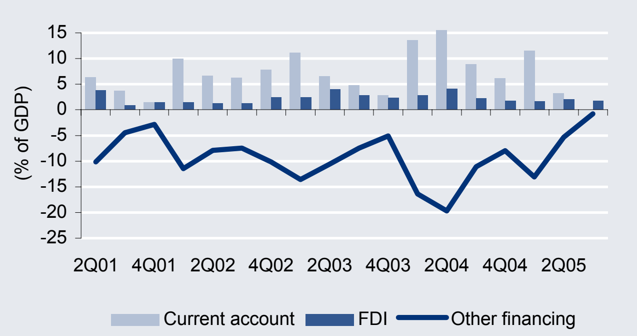
Muddling through from 2006-10

A number of blows have undermined positive sentiment since January 2005. In the space of one year, steel prices have fallen due to Chinese competition and record GDP growth has slumped. The French and Dutch 'No' votes on the EU constitution in 2Q05 mean eventual EU entry is in doubt. The sacking of Tymoshenko amid corruption allegations engulfing those around Yuschenko, hurt the president and split the anti-Yanukovich camp. Then the gas row with Russia, and the subsequent vote by the Rada against Yuschenko's government added another economic blow and a constitutional mini-crisis to the negative mix.

However, it is not all bad. Importantly, the budget deficit has been contained and is among the best in Europe. An amazingly successful re-privatisation of Kryvorizhstal brought in revenues of US$5bn and is a positive signal for other FDI which will remain larger than any C/A deficit. Beneath these positives remain the strong pro-Ukraine lobby in the EU from Poland and Lithuania, and the deeply undervalued currency.

The key reforms/events to look for now include 1) WTO entry, which may be held back as the US appears to want Ukraine to join with Russia, 2) Ukrtelecom privatisation as mooted by the president, and 3) judicial, social security and possibly pension reforms. The latter two depend on a 'good' election result, but this is very much in doubt. An increasingly plausible scenario for Ukraine is that it muddles through 2006-10 in a similar manner to 2001-04. It will be interesting to watch Polish and Russian reactions to the new post-March government.

Current account and financing

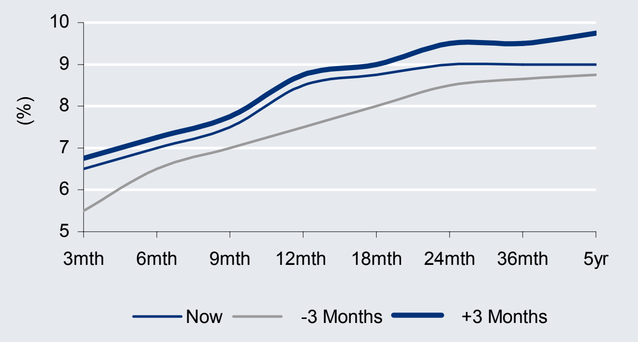


Source: National sources, ING estimates

Ukraine: Market directions

Domestic debt: Fair (rich)	External debt: Fair (fair)	Forex: Cheap (cheap)	Equities: Fair (fair)

Yield curve dynamics

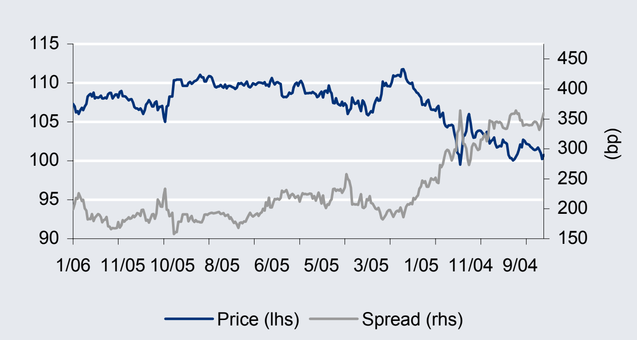


Little issuance this year

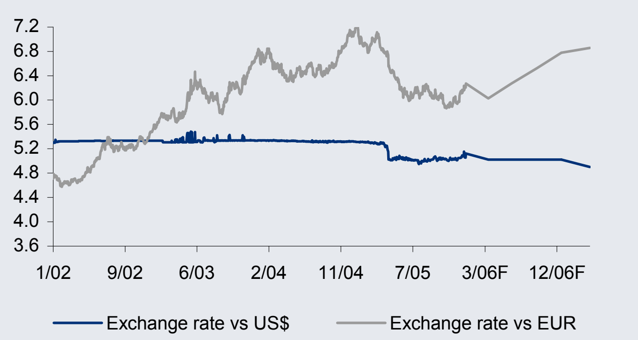
There is little in the way of issuance planned for this year as privatisation receipts mean the government has few borrowing needs. Yields are likely to remain low, below inflation, which we no longer believe is likely to fall significantly given 1) the gas price hike impact on inflation and 2) the much reduced likelihood of currency appreciation to drive down inflation. A rate hike is highly plausible to support the Uh regime. For external debt markets, Ukraine appears to have little to offer before the elections, though arguably relative to a peer like Brazil, more of its bad news is priced in, while more good news is priced into Brazil. The stock market is attracting greater foreign interest but remains small.

	3Q04	4Q04	1Q05	2Q05	3Q05	4Q05	1Q06F	2Q06F	3Q06F	4Q06F	1Q07F
Central bank key rate (%) end-Q	7.5	9.0	9.0	9.0	9.5	9.5	10.5	9.5	9.5	9.0	8.8
3mth rates (%) end-Q	6.0	9.0	4.3	5.3	5.2	6.0	6.3	6.3	6.0	6.0	6.0
6mth rates (%) end-Q	7.0	10.0	4.4	6.5	5.5	6.5	7.0	7.0	6.6	6.2	6.2
1yr rates (%) end-Q	9.5	11.0	4.6	8.0	6.5	8.0	8.3	8.0	7.8	7.5	7.0
1yr-6mth rates (bp) end-Q	250	100	17	150	100	150	125	100	122	130	80
3mth interest rate spread vs $-Libor (bp)	402	648	122	180	115	150	135	135	130	190	215
Real interest spread vs 3mth $-Libor (bp)	(395)	(243)	(1,045)	(974)	(893)	(515)	(343)	(651)	(714)	(646)	(698)
Uh/US$ end-Q	5.31	5.31	5.28	5.05	5.02	5.00	5.02	5.02	5.02	5.02	4.90
Uh/€ end-Q	6.54	7.20	6.84	6.11	6.07	5.90	6.02	6.28	6.53	6.78	6.86
Real exch rate index Uh/US$ (1/1/99 = 100)	88.9	86.3	77.8	73.0	73.8	73.0	66.8	65.6	65.4	64.8	64.9
Exch rate vol (ann, 90 day, % vs US$)	2.9	1.2	2.0	7.7	4.1	3.8	N/A	N/A	N/A	N/A	N/A

Ukraine 2013



Exchange rates



Source: National sources, ING estimates

Why we don't believe the Uh should depreciate

The currency has come under pressure to depreciate again, as it did in late 2004, again due to politics. Fundamentals still suggest the currency should be much stronger and should not be devalued. First, even paying much higher gas prices will only push the current account deficit into the low 1-3% of GDP range, which compares very favourably with most other EMEA countries. Second, with FDI more than covering this figure, the currency should be appreciating. Third, our PPP measure suggests Uh4/US$ is fair value, not Uh5/US$. Fourth, the NBU would lose credibility if it let the currency depreciate significantly, having only in 2005 allowed it to appreciate from the Uh5.3/US$ level. Fifth, a weaker currency would lift inflation, which may already be pressured by the rise in gas prices.

While we believe the currency should go stronger, in fact we have to accept that it will not do anything of the sort, at least in the coming six months. Indeed, band widening bringing more volatility and a temporarily weaker currency is possible (but with US$19bn of reserves, and plenty of room to hike rates, the NBU could ensure the weakness would be temporary). Beyond that anything could happen, but we have now made our base case no change in the Uh from end-2005 to end-2006, with potential for greater volatility within the Uh5.0-5.2/US$ range that the NBU has suggested may be acceptable.

We assume modest appreciation in 2007 only, and this forecast's longevity will depend on the March elections and economic data coming out in the next few months.

Ukraine: What's hot

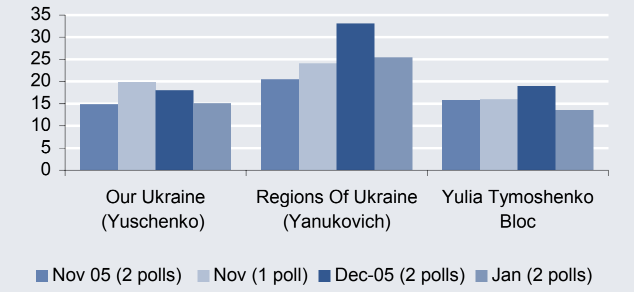
Distribution of seats in Ukrainian parliament

	Seats Jan-06		Polls Dec-05	Jan-06
Our Ukraine (Yuschenko)	**42**	Gov't	18	15
Socialist Party (Moroz)	**29**	Gov't	9	5
Other pro-government	**64**			
Yulia Tymoshenko Bloc	**37**	Opp	19	14
United Ukraine	**14**	Pro-Tymo		
Lytvyn's group	**21**	Opp		
People's Party	**41**	Pro-Lytvyn	6	3
Communist Party (Symonenko)	**56**	Opp	7	4
Regions Of Ukraine (Yanukovich)	**60**	Opp	33	25
Social-Democratic Party	**19**	Opp		
Other (independent/unoccupied)	**67**			

January to March 2006 – political mess

The political mess at the time of writing sees 1) a dismissed government that the president will not remove, 2) a parliament the president says has acted unconstitutionally, 3) a Supreme Court unable to decide who is right as parliament has refused to accept the president's nominees to replace vacancies, 4) uncertainty over the constitutional future, with the president talking of reversing half-enacted changes (due to be fully enacted after the March elections) if a possible referendum goes his way on election day. The changes include allowing parliament, not the president, to choose the premier. We do not have high hopes for any positive change before 26 March.

Opinion poll ratings



Post-March 2006 – political ...

At the time of writing, it is former premier Viktor Yanukovich who is in pole position eight weeks before the election. With roughly 30% support, and if constitutional changes take effect, he (or sponsor Akhmetov) should be best placed to form a government, leading to four years of difficult cohabitation with Yuschenko. If the changes are rejected in a referendum, Yuschenko's party may be able to work out a deal with Yanukovich, but we imagine relations would be strained. However, the same would apply to any deal with Tymoshenko given that the president sacked her in 2005, so a third option could even be a (unlikely) Tymoshenko-Yanukovich alliance. A truly 'good result', Yuschenko's party winning a majority, unfortunately looks impossible.

GDP figures don't add up (%YoY)

	2003	2004	2005F
GDP	9.6	12.1	2.4
Construction	23.1	18.4	-6.6
Retail	20.6	18.9	22.4
Wages	22.8	27.6	35.9
Loans (Uh bn)	65.1	91.8	143.3
Deposits (Uh bn)	56.3	84.0	132.9

GDP looks understated, and may remain so

It is somewhat surprising that Yanukovich is doing so well in the polls, given that real wages boomed 19% and available household income leapt by 20%, which is presumably the most positive income effect households have seen for decades. Meanwhile, household borrowing rose 2.3 times to Uh33.5bn and corporate borrowing by 62% to Uh143.4bn. Perhaps the population are dismayed by the official GDP figures, which track the output of the hammer and sickle, rather than the boom in services. These suggest GDP rose only 2% in 2005, which we find unbelievable. Indeed, we would not be surprised if this is revised in the future to 5-6%, and that 2004 figures are revised down when services are properly accounted for. Until then, reported growth may remain low.

Gas supply to Ukraine – moving away from Russia

Ukrainian gas supplies (bcm)	2004	2005F	2006F
Domestic production	20.3	20.4	20.5
Withdrawals	17	13.6	10.6
Imports from Russia	32.2	21.9	19.2
Imports from Central Asia	27	37.5	40
Total imports	59.2	59.4	59.2

That infamous gas deal

The dispute over gas prices was a re-run of many similar episodes in the 1990s with Russia caught between a desire to demand high prices for its energy exports to Ukraine, but also very dependent on Ukraine for transit of 130bcm of gas to Western Europe. Without transit rights, the gas is valueless, but Ukraine's dependence on Russian imports means its negotiating position has not been strong either. The January deal gives Gazprom a price of US$230 for some 15-20bcm of gas sold to Ukraine, but the average imported price of gas to Ukraine will be US$95, as Kazakhstan and Turkmenistan (loyal and dependent on Russia) will accept much lower prices for the 40bcm they sell to Ukraine. The latter could also demand higher prices in the future, meaning the problem has not gone away.

Source National sources, ING estimates

Ukraine: Key economic forecasts

	1998	1999	2000	2001	2002	2003	2004	2005F	2006F	2007F	2008F
Activity											
Real GDP (%YoY)	-1.9	-0.2	5.9	9.2	5.2	9.6	12.1	2.4	3.0	4.5	4.0
Private consumption (%YoY)	2.0	-1.9	2.5	9.6	9.5	12.6	14.0	10.0	5.0	5.5	5.0
Government consumption (%YoY)	-3.5	-7.9	1.0	10.3	-6.7	16.0	10.0	6.0	5.0	3.0	3.0
Investment (%YoY)	2.6	0.1	12.4	6.2	3.4	12.2	10.0	0.8	1.5	3.5	6.0
Industrial production (%YoY)	-1.0	4.0	12.4	14.2	7.0	15.8	12.5	3.1	3.0	10.5	6.5
Unemployment rate avg (%)	11.3	11.9	11.6	10.9	9.6	9.1	8.6	8.0	8.0	7.7	7.3
Nominal GDP (Uhbn)	103	130	170	204	226	267	346	401	454	516	575
Nominal GDP (€bn)	37.6	29.7	33.8	42.4	44.9	44.4	52.3	63.0	74.0	81.7	97.3
Nominal GDP (US$bn)	41.9	31.6	31.3	38.0	42.4	50.1	65.0	78.8	90.5	107	126
GDP per capita (US$)	837	636	635	784	883	1,053	1,376	1,671	1,925	2,276	2,704
Gross domestic saving (% of GDP)	18.5	22.9	24.8	23.4	23.6	22.9	23.8	24.9	25.3	26.3	26.0
Prices											
CPI (average %YoY)	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.6	10.3	9.0	7.5
CPI (end-year %YoY)	20.0	19.2	25.8	6.1	-0.6	8.2	12.3	10.3	10.2	8.6	6.0
PPI (average %YoY)	13.2	31.1	20.9	8.6	3.1	7.7	20.3	17.0	12.0	7.0	6.5
Wage rates (%YoY, nominal)	7.2	15.7	29.6	35.2	21.0	22.8	27.6	35.9	19.0	11.0	9.0
Unit wage costs (%YoY)	-5.5	-20.7	1.3	11.6	10.3	5.8	N/A	N/A	N/A	N/A	N/A
Fiscal balance (% of GDP)											
Consolidated government balance	-2.2	-1.5	0.6	-0.3	0.7	-0.2	-3.0	-2.0	-2.5	-1.5	-1.5
Consolidated primary balance	0.1	0.9	3.3	1.4	2.0	0.9	-2.0	-1.1	-1.5	-0.5	-0.5
Total public debt	48.1	61.0	45.3	36.5	33.5	29.0	24.7	20.4	19.3	18.3	16.2
External balance											
Exports (US$bn)	13.7	12.5	15.4	17.1	18.7	23.7	33.4	34.5	36.7	40.4	43.0
Imports (US$bn)	16.3	12.9	14.9	16.9	18.0	23.2	29.7	36.1	42.8	47.0	48.0
Trade balance (US$bn)	-2.6	-0.5	0.5	0.2	0.7	0.5	3.7	-1.5	-6.0	-6.6	-5.0
Trade balance (% of GDP)	-6.2	-1.5	1.6	0.5	1.7	1.0	5.8	-2.0	-6.7	-6.2	-4.0
Current account balance (US$bn)	-1.3	0.9	1.2	1.4	3.2	2.9	6.8	1.9	-2.0	-1.7	-2.0
Current account balance (% of GDP)	-3.1	3.0	3.9	3.7	7.5	5.8	10.5	2.4	-2.2	-1.6	-1.6
Net FDI (US$bn)	0.7	0.5	0.6	0.8	0.7	1.4	1.7	6.7	2.7	4.0	3.5
Net FDI (% of GDP)	1.8	1.5	1.9	2.0	1.6	2.8	2.6	8.6	3.0	3.8	2.8
Current account balance plus FDI (% of GDP)	-1.3	4.5	5.8	5.7	9.1	8.7	13.1	11.0	0.8	2.2	1.2
Export volume (%YoY)	1.2	-2.2	21.5	3.5	7.4	10.4	25.0	3.3	6.3	10.0	6.5
Import volume (%YoY)	2.0	-16.7	23.8	6.0	3.3	16.5	18.0	21.5	18.5	10.0	2.1
Foreign exchange reserves (ex gold, US$bn)	0.8	1.0	1.4	3.0	4.2	6.7	10.7	19.4	18.4	18.0	19.0
Import cover (months of merchandise imports)	0.6	1.0	1.1	2.1	2.8	3.5	4.3	6.5	5.2	4.6	4.8
Debt indicators											
Gross external debt (US$bn)	13.0	13.5	11.6	12.7	12.8	23.8	30.6	34.0	35.5	36.5	39.0
Gross external debt (% of GDP)	31.0	42.7	37.2	33.5	30.1	47.5	47.0	43.2	39.2	34.2	30.8
Gross external debt (% of exports)	94.8	108.3	75.3	74.4	68.4	100.3	91.5	98.4	96.7	90.4	90.7
Total debt service (US$bn)	2.2	2.1	2.7	2.7	2.9	2.8	3.0	3.2	3.3	3.7	4.5
Total debt service (% of GDP)	5.3	6.6	8.8	7.0	6.8	5.5	4.5	4.1	3.6	3.5	3.6
Total debt service (% of exports)	16.1	16.8	17.8	15.6	15.5	11.6	8.8	9.3	9.0	9.2	10.5
Interest & exchange rates											
Central bank key rate (%) year-end	60.0	45.0	27.0	12.5	7.00	7.00	9.00	9.50	9.00	8.50	8.00
Broad money supply (%YoY)	25.2	40.5	46.1	41.9	41.8	46.4	32.4	31.0	25.0	21.0	18.0
3-month interest rate (T-bill average %)	53.3	31.4	21.0	15.7	10.0	6.4	6.5	5.2	6.0	6.5	6.5
3-month interest rate spread over $-Libor (ppt)	47.7	26.0	14.4	12.0	8.3	5.3	4.7	1.1	1.7	2.2	6.5
12-month yield (average %)	49.9	29.9	N/A	16.7	10.8	9.4	9.5	6.8	6.5	7.0	7.0
Exchange rate (Uh/US$) year-end	3.43	5.22	5.43	5.30	5.33	5.33	5.31	5.00	5.02	4.70	4.40
Exchange rate (Uh/US$) annual average	2.45	4.13	5.44	5.37	5.33	5.33	5.32	5.09	5.02	4.84	4.55
Exchange rate (Uh/€) year-end	4.02	5.24	5.06	4.67	5.53	6.66	7.22	5.75	6.53	6.11	5.72
Exchange rate (Uh/€) annual average	2.73	4.39	5.03	4.81	5.03	6.02	6.61	6.37	6.14	6.32	5.92

Source: National sources, ING estimates

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