

September 29<sup>th</sup>, 2009

Regulated by the Bulgarian FSC

**KAOLIN**

www.kaolin.bg

Sector: Industrial minerals

 Recommendation: **HOLD**

 ISIN code..... BG1100039012  
 BSE (XETRA) code ..... 6K1  
 BLOOMBERG code ..... 6K1.BU  
 REUTERS code ..... KAO.BB  
 Indices..... SOFIX, BG40, BGTR30

 Last price (BGN)..... 5.67  
 52-week change ..... +2.16%  
 Market cap (BGN mln).... 141.8  
 P/E (on a TTM basis).... 17.0  
 P/Book..... 1.18


Prepared by:

**Desislava Petrovska – Financial analyst**
**Disclaimers**

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This corporate profile (analysis) has been drawn up by Euro-Finance Ltd. ("Euro-Finance") together with its

continued on last page

## KEEPS WALKING IN THE MIDST OF THE GLOBAL DOWNTURN

**Summary:**

- KAOLIN is the leading producer of industrial minerals in Southeastern Europe.
- KAOLIN incorporates 16 companies, 39 mines and 17 factories, located in Bulgaria, Serbia, Romania, Ukraine and Albania.
- Clients of KAOLIN are all major producers of glass, floor and wall tiles, sanitary ceramics and porcelain in the region.
- In 2007 KAOLIN announced a 5-year investment program amounting to BGN 125 mln. including: production capacity and productivity increase, reduction of costs, logistic optimization, R&D, greenfield investments, acquisition of new companies.
- In order to fund that program, KAOLIN raised it's equity with BGN 61.8 mln in April 2007 after a successful IPO.
- In 2008, in the midst of the financial crisis, another BGN 60.0 mln bank loans were granted to support investments. Although the significant debt rising, KAOLIN continues to maintain strong financial position and prudent solvency ratios.
- Two years later 80% of the investment program has been fulfilled. About 69% of the equipment in value is newly bought. New investments in Ukraine will boost this ratio to 81%.
- KAOLIN shares are listed on BSE-Sofia. KAOLIN is a component of all three BSE indices – SOFIX, BG40 and BGTR30. The company is included in Vienna Stock Exchange index Bulgarian Traded Index (BTX).
- At the moment shares of KAOLIN are traded with discount of 58% against its IPO price of BGN 13.50 per share. After the peak levels registered in October 2007 stock price made a huge plunge to a record low of BGN 2.15 in mid-February 2009.
- KAOLIN will distribute a gross dividend of BGN 3.75 mln or BGN 0.15 per share of its net profit for 2008. The remaining BGN 5 mln will be reinvested.

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Source: Bloomberg

## 1. Industrial Minerals Market and Competitive Environment

2008 was marked by a gradual downturn in economic conditions in America and Europe. This drop worsened sharply in the fall, resulting in an unprecedented slump in sales volumes in the last months of the year.

Markets of building materials, ceramics and other housing-related markets were particularly affected. Demand in the paper sector decreased and the industrial base underwent further restructuring in developed countries. Only in Asia trends remained positive.

### INDUSTRIAL MINERALS

Complete list of industrial minerals include about 4,000 varieties, but this issue is focused only on industrial minerals produced by KAOLIN.

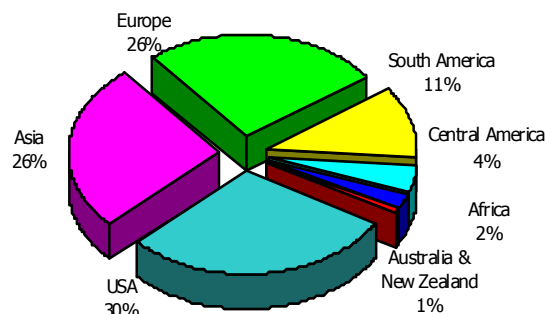


PRODUCT	INDUSTRY
<b>Kaolin</b>	Paper, ceramics, rubber, plastics, paints
<b>Silica sand</b>	Glass, ceramic bodies and glazes, dry mixtures and concrete
<b>Feldspar</b>	Ceramics and glass
<b>Chamotte</b>	Sanitary ware
<b>Dolomite</b>	Glass, construction, ceramics
<b>Limestone</b>	<ul style="list-style-type: none"> <li>◆ Removing harmful sulphur pollution from gases emerging from power stations;</li> <li>◆ Polyethylene, rubber and paint, road coverings, filler for asphalt;</li> <li>◆ Full-value combined fodders for all kind of animals and birds.</li> </ul>

#### → Kaolin

The worldwide production of kaolin amounted to 25 mln. tons in 2007. For the same year Bulgarian production was 240,000 tons, or 1.0% of the total amount. The large-scale producers of kaolin are USA, China, Brazil, United Kingdom and Republic of Korea, accounting for 62.3% of the world output in 2007. Only USA produces about 30% of the total output. In Europe the largest producers are United Kingdom, Germany and Czech Republic. For the period 2003 – 2007 the total kaolin production grew with 8.1%.

### Worldwide allocation of kaolin production '07



Source: U.S. Geological Survey Minerals Yearbook - 2007

In Central and Eastern Europe kaolin output amounted to 2.2 mln tons in 2007. The largest producers in CEE were as follows:

- the Czech Republic – 682 thousand tons, or 31.7% of total output in the region;
- Turkey – 600 thousand tons, or 27.9% of total regional output. Turkey produces mainly crude kaolin, which is much cheaper than calcinated kaolin.
- Albania – 300 thousand tons (14.0% of total production in the region);
- Bulgaria – 240 thousand tons (11.2% of output).

The global economic downturn hit the industry and created challenges for established mines, some more than a century old, to increase yields and quality of production, in order to remain competitive. At the same time, since the 1990s, kaolin industry has been suffering from increased competition in its main market – paper, which consumes about 85 percent of the industry's output. Kaolin producers are required to deliver kaolin, which meets tighter specifications and are challenged to maximize mill efficiency and product offerings. This led to structural changes in the industry, including capacity closures in the United States and UK and expansions in Brazil. Since kaolin occurs in a variety of physical and chemical forms, mining and processing operations have to be customized in order to best match the characteristics of each deposit.

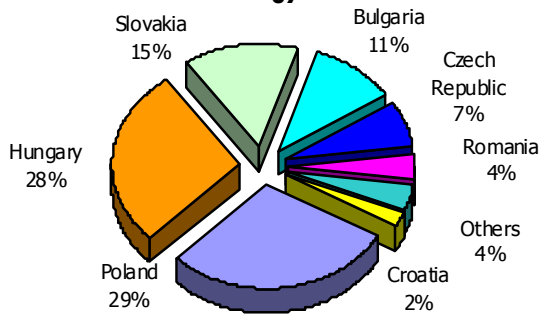
#### → Silica sands

Deposits of industrial sand worldwide are abundant. The extraction of sand, however, is sometimes economically unprofitable due to the geographic distribution, environmental restrictions and quality requirements in a number of industries. For the period 2003 – 2007 the world production of silica sands grew by 7.7%. According to the estimates the total production of industrial sand for 2007 came up to 126 mln tons. The biggest producers of silica sands in 2007 were:

- the USA – 30 mln tons, or 23.8% of total output;
- Italy – 13.8 mln tons, or 11% of total output.
- Germany – 7.7 mln tons, or 6.1% of total production;

Bulgaria produced 1.5 mln tons silica sand in 2007. Compared to 2003 production almost doubled.

### CEE production of silica sand '07

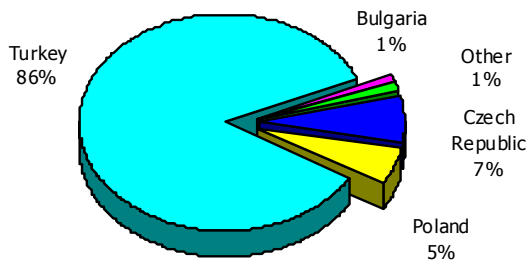


Source: U.S. Geological Survey Minerals Yearbook - 2007

### → Feldspar

Feldspar is produced in more than 50 countries. In 2007 worldwide feldspar output amounted to 22,5 mln tons. The biggest producers of feldspar are Turkey – 6 mln tons, Italy – 4,7 mln tons and China – 2,3 mln tons. They produce 58% of the world output. In Bulgaria are produced 90,000 tons.

### Feldspar production in CEE by country '07



Source: World Mineral Production – British Geological Survey 2007

Demand of chamotte and dolomite was affected by the weakening construction sector that hit ceramics and building materials markets. With the construction and steel industries bogged down in recession, worldwide demand for limestone also fell down.

The first quarter of 2009 confirmed a historical drop in all markets and virtually all geographic zones since November 2008. The trend remained negative in the construction sector in Europe and North America, where housing starts reached record low levels early in the year. Global paper production decreased by approximately 13%. Only some consumer-related markets held out better.

The biggest challenge that face mineral producing companies, except slowing demand, are the rising costs of energy including natural gas and electric power. In addition, higher transportation charges for shipping products by rail and truck increase delivery costs of raw material for industrial consumers. That makes product quality, transportation costs, reliability of deliveries and comprehensive logistics solutions key for this industry.

In 2009 factors such as decreased realization of products as well as the burden of fixed expenses, additionally choked companies in the sector.

### COMPETITIVE ENVIRONMENT

Below are the main competitors of the company in the domestic kaolin market, as well as in the East European region:

- The Czech Republic is the biggest producer of kaolin in Eastern Europe. Its main competitive advantages include good quality and high delivery reliability, while the disadvantages are related to higher price and the geographical remoteness from the Balkans and Italy (as main markets for kaolin);
- Ukraine has a huge production potential due to its considerable deposits of kaolin. Since the beginning of 1990s the sales of Ukrainian kaolin have faltered affected by the country's loss of market share in Russia. Ukraine's major advantage are the relatively lower prices, while its disadvantages are related to inconsistent quality, the delivery unreliability and geographical remoteness from the markets of Western Balkans.

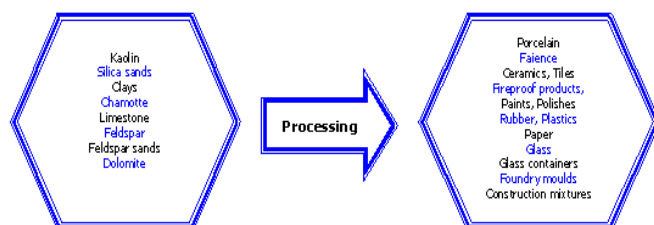
KAOLIN's main competitors in the regional glass sand market include local manufacturers of feldspar sands and a number of silica sand importers, supplying quartz sands from France, Belgium, Egypt and Germany. The competitive advantages of KAOLIN in this particular line of business are low prices, comparable quality, delivery reliability, large-volume supply. Due to the increased consumption of sand in Bulgaria and Romania, KAOLIN has substantially limited its sales on the Italian market since 2006.

### IMPORTANT INDUSTRY TRENDS IN 2008

- ✓ Demand for minerals used in ceramics (clays, feldspar, kaolin, ground silica, etc) dropped overall in Europe in 2008 after slight growth in the previous year. North American markets has continued to decline, since it is partly related to the construction sector.
- ✓ Global increase in glass and cement production helped to uphold demand in refractory minerals (chamottes, calcinated kaolin, silica, etc)
- ✓ Kaolin, dolomite, feldspar, ball clays, etc. in Europe is partly linked to activity in the construction industry. In 2007 following the strong growth on construction markets, this activity went through a drop that worsened in the second half with a slump in construction markets in some countries in Europe. Printing and writing grades market fell by 3.3% in 2008 as a consequence of the weakening demand.
- ✓ In North America a significant slump of the new residential construction has adversely affected the business with Kaolin, dolomite, feldspar, ball clays, etc. hitting number of key markets (roofing, PVC siding, joint compound, paints and coatings). Activity remained poor throughout 2008 with a further decrease in new housing compared to 2007. In North America paper production decreased by 6.8% in 2008, while the Asian markets further grew in 2008 with 2.6% following an increase in local production. In South America the growth of kaolin, dolomite, feldspar, ball clays, etc. remained solid until the very end of 2008, where the general downturn in all markets affected volumes.

## 2. KAOLIN Overview

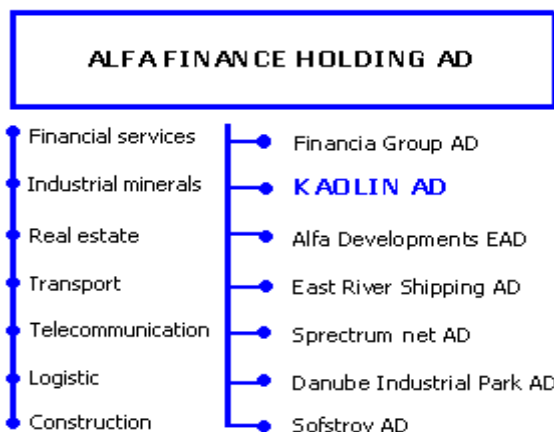
KAOLIN mines and processes kaolin, quartz sand, clays, chamotte, marlstone, feldspar, dolomite, ceramic dust, etc. In Bulgaria the company has production capacities in Vetovo, Senovo, Kaolinovo, Varna, Topolovgrad, Haskovo, Gorna Oryahovitza and others. The main markets of KAOLIN are Bulgaria, Romania, Italy, Turkey and Egypt.



### SHORT HISTORY

KAOLIN is established in 1924 and exploited deposits around the town of Kaolinovo. Twelve years later was incorporated another mining company that exploited deposits in Vetovo and Senovo. After nationalization of kaolin industry in 1947, two state companies were established, which were merged into one state mining company. After the communist regime collapsed in 1989 the state company was terminated and was established "KAOLIN". It inherited all assets and liabilities of the dissolved company. In 2000 a shareholding of 75% became part of Alfa Finance Holding AD (AFH) after disputed privatization deal – a common peculiarity of local privatization process. Disturbing was the fact that privatization valuation was prepared by "Bulbrokers" – investment intermediary owned by Alfa Finance. A few months later the capital of KAOLIN was hiked under the condition that all new shares will be subscribed by Alfa Finance Holding AD.

Despite privatization turbulence, in KAOLIN were invested serious funds. The amount of investments exceeded BGN 10 mln only a year after privatization. In 2007 the capital of KAOLIN was increased by 25% after an IPO on the Bulgarian Stock Exchange. Currently Alfa Finance Holding AD owns a 67.85% stake in KAOLIN. Alfa Finance Holding AD is established in 1999 and its main line of business is acquisition, management, valuation and sale of stakes in domestic and foreign companies.



**ALFA FINANCE HOLDING AD** IS CONTROLLED BY **IVO PROKOPIEV**. MR. PROKOPIEV IS A BULGARIAN BUSINESS MAGNATE, A CHAIRMAN AND SHAREHOLDER IN ALFA FINANCE HOLDING AD AND ECONOMEDIA AD – TWO GROUPS THAT COMPRISE COMPANIES OPERATING IN THE FIELD OF MEDIA, ADVERTIZING, MINING, FINANCE, IT, REAL ESTATE AND OTHERS. SINCE DEMOCRATIC CHANGES IN BULGARIA MR. PROKOPIEV HAS PARTICIPATED IN DECISION MAKING AND PROBLEM SOLVING GROUPS ABOUT ECONOMIC AND SOCIAL ISSUES. AS A CHAIRMAN OF CEIBG (CONFEDERATION OF THE EMPLOYERS AND INDUSTRIALISTS IN BULGARIA – [WWW.CEIBG.BG](http://WWW.CEIBG.BG)), MR. PROKOPIEV IS ONE OF THE INITIATORS OF THE ANNUAL MEETINGS BETWEEN BUSINESS AND GOVERNMENT LEADERS.

From an enterprise focused entirely on kaolin, KAOLIN became a regional leader in the field of industrial minerals, operating in seven different countries. In the period 2001 – 2008 were made significant investments in new companies that enlarged product portfolio of the company. These steps aimed at expansion on new markets and gaining of market share. Some of these investments were sold and as of June 30, 2009 KAOLIN owns twelve subsidiaries – four in Bulgaria (Magma – 97 AD, Ogneuporni Glini AD, Solarpro AD, Orel Keramika AD), three in Ukraine (KAOLIN Azov, "Promineral, PKSP), two in Albania (M.I.D and KAOLIN Albania) and one in Romania (KAOLIN Mineral), Serbia (YugoKAOLIN AD) and Turkey (KAOLIN Industriel Mineraler).

In January 2001 KAOLIN acquired majority shareholding in the company for exploitation and processing of feldspar and dolomite "Magma – 97" AD. Two years later – in 2003, KAOLIN made its first investment abroad – Serbian YugoKAOLIN. The company exploits and trades with sands and clays. In the same year YugoKAOLIN bought Serbian Kopovi – a leader in production of quartz sand and ceramic clays on the Western Balkans market.

In the period 2004 – 2006 KAOLIN established four new companies in the Black sea region – industrial minerals traders KAOLIN Industriel Mineraler (Turkey) and KAOLIN Mineral (Romania), Ukrainian Promineral and producer of quartz sand KAOLIN Azov. In 2006 KAOLIN acquired Bulgarian Ogneuporni Glini AD – a company for mining and processing of refractory clays, silica sands and chalk.

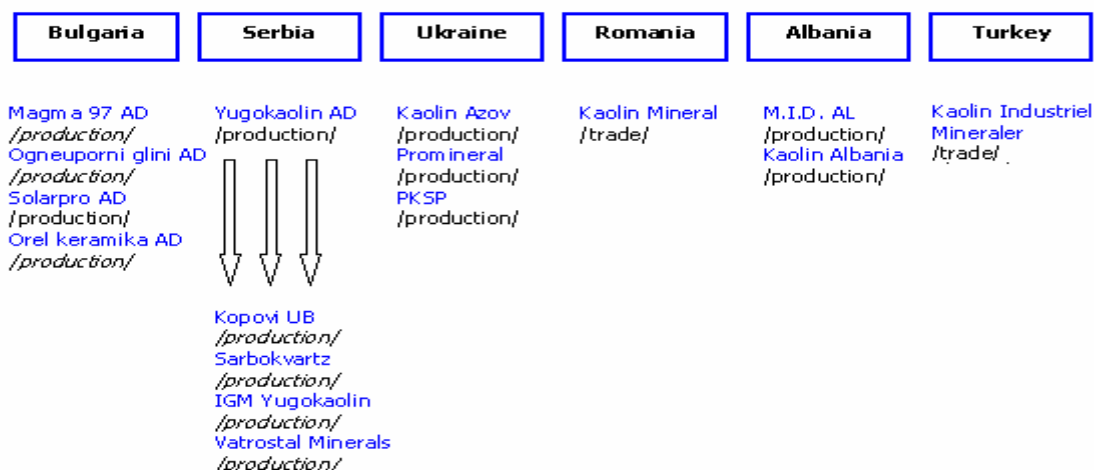
YugoKAOLIN continued its expansion in 2008, when it acquired four new companies – Srbokvarc – the biggest producer of quartz sands in the former Yugoslavia, IGM YugoKAOLIN – a company for exploitation and processing of clay as well as clay products, including bricks, Vatrostal Minerals – manufacturing of products of asbestos, graphite and other minerals and Rudnik Nemetala, which was taken over by Kopovi.

In 2007 was incorporated producer of photovoltaic solar modules Solarpro AD and were bought the main limestone producer in Albania - M.I.D. and the second biggest producer of silica sand in Ukraine PKSP. Despite the global financial crisis, except the subsidiaries of Serbian YugoKAOLIN, in 2008 were acquired Bulgarian manufacturer of ceramics products - Orel Keramika AD and KAOLIN Albania, which strengthened position of KAOLIN in Albania.

Companies from the group KAOLIN mine, process and trade with more than 180 products, that are different types of silica sand, kaolin, limestone and others, adding value to the various types of industrial minerals.

## Corporate structure

### "KAOLIN" AD



At present KAOLIN exports almost half of its production. In 2008 the company sold on the foreign market 49% of its output. The share of domestic sales slid from 89% to 51% in 2008 compared to 2007. Romania is the biggest foreign market of KAOLIN. Shares of Italy and Turkey in the export dropped due to the downturn in ceramics market affected by the global economic crisis. The company succeeded in countering the weak market demand through regional expansion, cost reduction and diversification of markets and products. KAOLIN is very active in the field of product innovations and develops new products for ceramics, paper and rubber industries, food industry and road covering.

KAOLIN develops ambitious investment program aiming at geographic expansion in Southern and Southeastern Europe through acquisitions. Mines and factories in Serbia, Ukraine and Bulgaria were bought in the last 3 years. KAOLIN spent BGN 7.4 mln on equity acquisitions, but till H1 2009 they were followed by another BGN 40.7 mln for direct capital hikes. KAOLIN fulfils its investment plans even in the period of economic slump. At the same time the company prioritized its investments and optimized its strategy and as a result few projects were ceased in Q3 2008.

Since the rising energy and fuel prices are essential for company's performance, KAOLIN makes moves towards restraining of their influence over company's results. The company made significant energy saving investments during the recent years. The basic capacities of KAOLIN are gasificated and the power source in one of its units was changed in order to reduce costs.

The company adopted a "green" strategy and strictly follows it. This strategy orients operations towards production of new products and solutions directed to reduction or minimizing the impacts on natural environment. A product of this new direction and of company's ambitions in the solar energy sector, was the establishment of "Solarpro" AD – a company for producing of thin-film PV modules and building of PV power-plants. "Solarpro" is a part of KAOLIN 's strategy for development of "green" products, focused on conservation of environment. Production base and technological equipment of "Solarpro" were installed and production was launched in the first half of 2009. The total amount of investments, through both equity and debt, is

expected to reach BGN 30 mln. The plant has capacity of 18 MW thin-film PV modules per year, which will be reached in 2010, when all three production lines will operate at full capacity. The biggest part of production is expected to be realized on domestic market, since in accordance with EU requirements, till 2020 20% of the electric power used in Bulgaria should be from renewable sources and 5% of them are intended to solar energy, which is not used at present. In Bulgaria the price for purchased solar electricity is almost fixed for a 25-year period. The State Energy and Water Regulatory Commission can change the price with no more than 5% per annum.

Maintaining the leading position on the regional market of industrial minerals and seizing the opportunity offered by the current economic situation for expansion on new markets are company's main targets. Results deriving from investment activity are expected to contribute to profitability of the company and maintain its indicators at sound levels and thus offset the negative effect of the slowing demand.

#### STRENGTHS AND OPPORTUNITIES

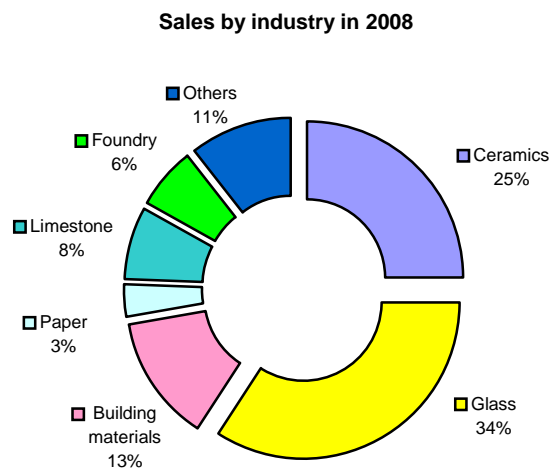
- ✓ Company with traditions in the mining sector
- ✓ Modern machines, plant and equipment
- ✓ Well-diversified portfolio, which includes products for glass and paper industry, ceramics, construction, founding and others.
- ✓ Well – developed research department
- ✓ High level of product quality control
- ✓ Environmentally responsible company
- ✓ ISO certified for 9001:2000 Quality Management Standards
- ✓ A part of the leading Bulgarian industrial and financial group Alfa Finance Holding AD

#### WEAKNESSES AND RISKS

- ✓ Global concerns of construction sector slowdown, following the USA mortgage crisis.
- ✓ Highly correlated with the economic cycle
- ✓ Dependent on the prices of energy and fuel
- ✓ Seasonal production
- ✓ Increasing level of debt
- ✓ Rising intra-group indebtedness
- ✓ Traditional fast-growing problems of Alfa Finance Hold.

### 3. Financial Overview

During the last few years the company demonstrated stable growth, clearly evidenced through the steady increase of the net profit. In 2008 slowing demand raised by the global economic turmoil in combination with the record prices of energy and fuels led to significant decrease of the annual results of KAOLIN. Nevertheless, sales jumped with 21% compared to 2007. Ceramics, production of glass and building materials amounted to 69% of the sales of KAOLIN as of December 31, 2008. Sales of silica sand have a major share in the structure of sales due to the higher demand in the glass industry on the account of the lower demand in ceramics. Subsidiaries generate about 20% of the annual revenues of KAOLIN. The biggest share has Serbian "Yugo KAOLIN " AD followed by Ukrainian "PKSP". In H1 2009 Solarpro AD held the largest share in sales generated by KAOLIN 's subsidiaries followed by Serbian Kopovi and Serboquartz. A new plant in Ukraine for dressing of quartz sand is expected to be put into operation in the next quarter.



Source: KAOLIN consolidated annual report 2008

In 2008 KAOLIN made major capital expenditures and doubled its property, plant and equipment item, which resulted in assets increase of 46% compared to 2007. The large investments led to a drop of cash and cash equivalents with 41% in 2008 and to significant rise of the long-term liabilities due to received bank loans. In spite of the large bank debt, the company maintains sound capital structure with equity/liabilities ratio of 1.14 as of December 31, 2008. In H1 2009 indebtedness ratios slightly deteriorated due to the bigger current bank loans. Debt/equity ratio rose to 0.94 from 0.88 as of the end of 2008.

Liquidity ratios remained at reasonable levels, that allows company to be flexible managing its cash flows. In addition KAOLIN accumulated considerable amount of reserves as of the end of the H1 2009 - BGN 88,5 mln, which could cushion the risks of negative impacts on the industry.

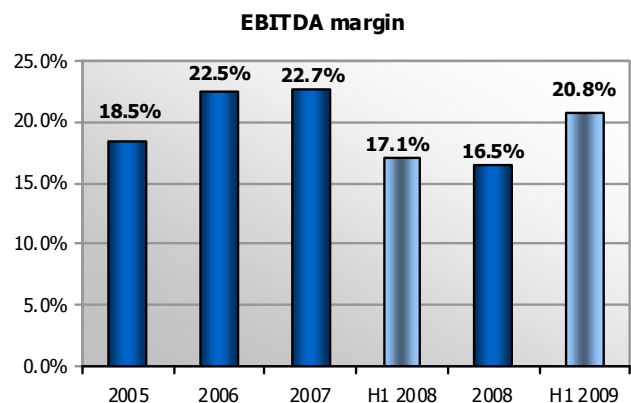
In the recent years depreciation and amortization expenses rose significantly due to the serious capital expenses made in 2007 and 2008, mirrored by the huge increase of the property, plant and equipment. Since the company is not affected by lack of capacities, significant part of investments

are directed towards improving of energy efficiency, environmental performance and quality of production. To avoid the considerable consumption of natural gas most of the technological lines were in planned outage from mid-December 2008 to mid-March 2009. In this period gas prices hit their annual record levels and activity of the company was brought only to commercial activity, so KAOLIN was selling some of its inventories, accumulated in Q3 and Q4 2008. Due to this outage, materials expenses dropped with 38% in Q1 2009 compared to the same period last year.

Another measure for offsetting the negative influence of the global crisis was laying-off of 10% of the personnel in the end of 2008, aiming at reduction of operating costs. The effect from this optimization was clear in the first half of 2009, when operating expenses dropped with 16% compared to the same half last year.

In 2008 KAOLIN diversified its income sources by establishing "Solarpro" AD - the biggest solar panels plant on the Balkans. The photovoltaic power station of Solarpro AD was put into operation in the first half of 2009 and is expected to operate in full capacity till the end of the year. Revenues of the company for H1 2009 amounted to about BGN 3.2 mln and generated almost 6% of KAOLIN 's total revenues. In July the capital of Solarpro was hiked to BGN 24 mln. "Solarpro" AD is a part of KAOLIN 's strategy for development of "green" products focused on conservation of environment.

In H1 2009 revenues of KAOLIN dropped with 18.4% to BGN 53.3 mln compared to the same period last year. Due to the serious measures aiming at optimizing of production activity such as lay-offs, put into operation of new technological capacities, expanding of product range and entering new markets, KAOLIN did not admit the new challenging conditions to hurt its EBITDA, which, compared to H1 2008, remained almost unchanged at BGN 11.5 mln. EBITDA



margin improved and reached 20.8% in H1 2009.

After the peak levels reached in 2007, profitability ratios of KAOLIN plunged in 2008 due to the lower net earnings. Net profit margin shrank to 7.6% from the high of 16.7%, registered in 2007. In H1 2009 net profit margin slightly improved to 7.9%.

In the second quarter of 2009 the decrease of operating expenses correspond to the drop of revenues. As a result the operating profit and net earnings remained almost flat at BGN 4.4 mln.

## 4. Key Financials

Balance Sheet and Income statement highlights (audited, consolidated)

figures in thousand BGN

Balance Sheet				
ASSETS	2006	2007	2008	June 30, 2009*
<b>FIXED ASSETS</b>	<b>49,991</b>	<b>64,764</b>	<b>126,353</b>	<b>128,755</b>
Property, plant and equipment	46,146	55,962	110,041	113,714
Goodwill	2,848	7,072	13,678	13,211
Intangible assets	747	1,522	2,271	1,597
Other	250	208	363	233
<b>CURRENT ASSETS</b>	<b>51,901</b>	<b>89,361</b>	<b>97,954</b>	<b>105,023</b>
Inventories	11,903	19,185	27,308	29,512
Trade receivables and advances	22,468	33,586	36,264	38,906
Receivables from related parties	11,444	184	6,436	15,138
Other	3,294	3,012	8,156	6,280
Cash and cash equivalents	2,792	33,394	19,790	15,187
<b>TOTAL ASSETS</b>	<b>101,892</b>	<b>154,125</b>	<b>224,307</b>	<b>233,778</b>
<b>EQUITY AND LIABILITIES</b>				
<b>SHAREHOLDER'S EQUITY</b>	<b>38,292</b>	<b>117,926</b>	<b>119,377</b>	<b>120,217</b>
Paid-up capital	3,403	25,000	25,000	25,000
Reserves	19,219	63,548	78,878	82,388
Accumulated profit (loss)	14,510	26,683	9,887	5,068
<i>Minority shareholdings</i>	<i>1,160</i>	<i>2,695</i>	<i>5,612</i>	<i>7,761</i>
<b>LONG TERM LIABILITIES</b>	<b>7,085</b>	<b>3,981</b>	<b>58,134</b>	<b>59,429</b>
Granted long-term loans	1,955		52,516	54,295
Other	5,130	3,981	5,618	5,134
<b>CURRENT LIABILITIES</b>	<b>56,515</b>	<b>32,218</b>	<b>46,796</b>	<b>54,132</b>
Granted short-term loans	34,996	12,250	20,387	30,780
Liabilities to suppliers and clients, advances	10,736	10,378	19,689	14,546
Other	10,783	9,590	6,720	8,806
<b>Total liabilities</b>	<b>63,600</b>	<b>36,199</b>	<b>104,930</b>	<b>113,561</b>
<b>EQUITY AND LIABILITIES</b>	<b>101,892</b>	<b>154,125</b>	<b>224,307</b>	<b>233,778</b>

all figures in thousand BGN

Income Statement					
	2006	2007	2008	June 30, 2009*	June 30, 2008*
Operational income	88,613	118,394	142,729	55,386	66,733
Operational expenses (excl. amortization and depreciation)	-74,820	-99,945	-129,660	-43,857	-55,312
<b>EBITDA</b>	<b>19,912</b>	<b>26,824</b>	<b>23,488</b>	<b>11,529</b>	<b>11,421</b>
Amortization and Depreciation	-6,119	-8,375	-10,419	-6,561	-4,630
<b>EBIT</b>	<b>13,793</b>	<b>18,449</b>	<b>13,069</b>	<b>4,968</b>	<b>6,791</b>
Other financial income/expenses (net)	-2,654	2,565	-1,238	-765	-610
<b>EBT</b>	<b>11,139</b>	<b>21,014</b>	<b>11,831</b>	<b>4,203</b>	<b>6,181</b>
Taxes	-1,707	-2,362	-1,491	-	-
<b>Net income</b>	<b>9,432</b>	<b>18,652</b>	<b>10,340</b>	<b>4,203</b>	<b>6,181</b>
<i>Including minority shareholdings</i>	<i>248</i>	<i>540</i>	<i>649</i>	<i>199</i>	<i>427</i>
Shares outstanding	3,403	25,000	25,000	25,000	25,000
EPS	2.77	0.75	0.41	0.17	0.25
Dividend per share	-	0.3	0.15	-	-

\*Unaudited, consolidated

Key Ratios					
	2006	2007	2008	June 30, 2009	June 30, 2008
<b>Profitability</b>					
EBITDA margin	22.5%	22.7%	16.5%	20.8%	17.1%
Profitability of sales	11.4%	16.7%	7.6%	7.9%	-
Profitability of equity	24.6%	15.8%	8.7%	7.0%	-
Profitability of assets	9.3%	12.1%	4.6%	3.6%	-
<b>Efficiency</b>					
Efficiency of expenses	1.12	1.17	1.07	1.10	1.10
Efficiency of sales	0.90	0.85	0.93	0.91	0.91
<b>Liquidity</b>					
Current ratio	0.92	2.77	2.09	1.94	-
Quick ratio	0.71	2.18	1.51	1.39	-
Cash ratio	0.05	1.04	0.42	0.28	-
<b>Capital structure and indebtedness</b>					
Equity/Assets	0.38	0.77	0.53	0.51	-
Liabilities/Assets	0.62	0.23	0.47	0.49	-
Equity/Liabilities	0.60	3.26	1.14	1.06	-
Liabilities/Equity	1.66	0.31	0.88	0.94	-
Long-term liabilities/Equity	0.19	0.03	0.49	0.49	-
Short-term liabilities/Equity	1.48	0.27	0.39	0.45	-
Leverage	2.66	1.31	1.88	1.94	-
<b>Dividend ratios</b>					
Dividend cover	-	2.49	2.76	-	-
Dividend payout	-	0.40	0.36	-	-
<b>Market ratios</b>					
P/E	-	23.3	8.3	10.2*	21.9*
P/B	-	3.69	0.72	0.71	2.21
P/S	-	3.88	0.63	0.65*	2.04*

\*TTM

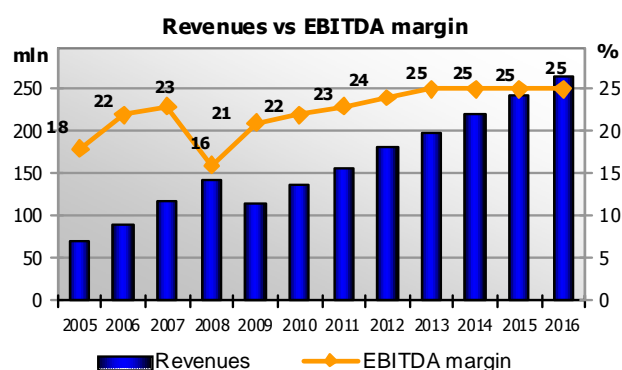
## 5. Valuation

- *DCF Valuation*

KAOLIN was valued on a 2 – stage DCF model for a 8-year period (2009 – 2016). Stage-1 comprises the years from 2009 to 2013, while Stage-2 includes the years from 2014 to 2016. DCF valuation is based only on results of KAOLIN from the main activity – mining and processing of industrial minerals. Solarpro AD is eliminated from valuation since its activity is not included in the main purpose of business of KAOLIN, but this investment is added to the value of the company in the end.

Stage-1 includes the years, when the company is expected to develop at a steady pace, while in Stage-2 KAOLIN is expected to continue its stable path and to maintain its ratios, reached in 2013. In 2009 revenues of KAOLIN are forecasted to slump as a result of the weaker market affected by the global economic crunch that will hurt company's results. According to our estimates revenues from the main activity will drop with 20% in 2009, but in the next year the negative effect will slow down and the company will gain momentum. A rise of 20% is forecasted for the year 2010, that will be the highest growth in the period under review. Then the revenues will gradually decrease and will

reach 10% in 2013 and will stabilize at this level during the second stage. In 2009 EBITDA margin of the company is expected to remain at the level registered in Q2 – 21%. Then it will gradually rise to 25% in 2013 and will be maintained at this level for the remaining of the period.



Basic model assumptions in Stage-1	2009	2010	2011	2012	2013
Revenues growth (%)	-20	20	15	15	10
EBITDA margin (%)	21	22	23	24	25
Tangible assets growth (%)	6	6	6	6	6
A&D-to-Revenues (%)	12.0	11.5	11.0	10.5	10
NWC change (BGN mln)	-10	-5	-5	0	2

Stage-2 DCF assumptions are equal to 2013 assumptions.

Weighted-average cost of capital is assumed at 11.6% with cost of equity of 14% and cost of debt of 9%. Debt-to-Equity ratio is calculated taking into account only the interest-bearing debt. In 2008 debt-to-equity ratio is 0.70 and in H1 2009 is 0.80. Since the rise of the ratio in Q2 2009 is due to the significant rise of the current bank loans, in the forecast is implied a capital structure of 0.70, which will be kept at this level in the future years.

During the last few years KAOLIN financed its investment program mainly using debt, but in the future years we expect that company will use depreciation as a main source of funds for its development. KAOLIN strictly executes its plans for strategic development and expectations for the period 2009 – 2016 are investments to increase gradually in line with the rise of tangible assets. In the calculation of the terminal value we assume 2% long-term growth rate, that corresponds to the expectations for the long-term economic growth.

We consider that appropriate estimation of KAOLIN 's subsidiary Solarpro AD, as a new company, is its net worth. Since the company does not prepare interim financial statements, there is no information about its net worth for Q2 2009, but according to KAOLIN 's H1 report the capital of Solarpro AD was hiked to BGN 24 mln and in our estimate we used this value by adding it to the net value of KAOLIN.

**According to our valuation net value of KAOLIN is BGN 188,952 thousand, including Solarpro AD. This represents an estimated price per share of BGN 7.56.**

- *Peer group analysis*

None of the companies traded on the Bulgarian Stock Exchange is engaged in the field of industrial minerals. Worldwide the company operates in a very competitive sector. In Europe very few of its competitors are public companies. In addition, some of them are corporate giants and have diverged activities and products. Our selection includes four French companies traded on the Paris Stock Exchange:

- ◆ **Imerys S.A.** - extraction and processing of minerals.
- ◆ **Compagnie de Saint Gobain S.A.** – construction, high-performance materials and packaging
- ◆ **Lafarge S.A.** - building materials
- ◆ **Vicat S.A.** - building materials

**Market ratios of the selected companies:**

	P/E	P/S	P/B
	TTM*	TTM*	MRQ*
<b>Imerys</b>	<b>96.7**</b>	<b>1.0</b>	<b>1.71</b>
<b>Compagnie de Saint Gobain</b>	<b>33.3</b>	<b>0.44</b>	<b>1.11</b>
<b>Lafarge</b>	<b>13.8</b>	<b>0.97</b>	<b>1.23</b>
<b>Vicat</b>	<b>10.9</b>	<b>1.12</b>	<b>1.24</b>

Source: Reuters

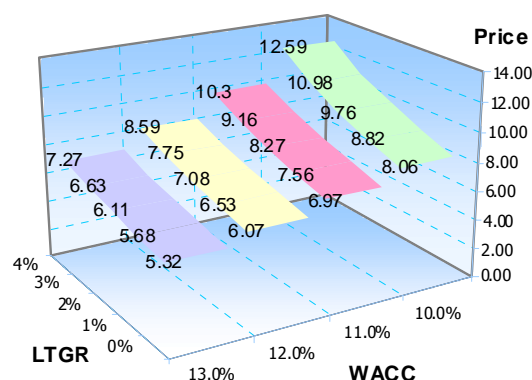
\* TTM – trailing twelve months; MRQ – most recent quarter  
 \*\* excluded from valuation

As of June 30<sup>th</sup> 2009 earnings per share and sales per share of KAOLIN on a TTM basis are 0.33 and 5.26, respectively. Book value per share is 4.55. Using the average values of the three ratios, the price per share of KAOLIN is estimated at BGN 4.81. This value should be corrected with liquidity premium since the companies from the peer group are actively traded on the Paris Stock Exchange. The liquidity premium is defined at 20%.

**According to the peer group analysis the price for one share of KAOLIN is BGN 4.64.**

**FOR THE TWO METHODS OF VALUATION WERE USED EQUAL WEIGHTS. AS A RESULT WE HAVE REACHED A FAIR VALUE OF KAOLIN OF BGN 152.5 MLN OR BGN 6.10 PER SHARE.**

The following table presents the price for one share of KAOLIN in accordance with different levels of weighted average cost of capital and long-term growth rate. The most pessimistic version includes WACC of 13% and long-term growth rate of 0%, that gives BGN 5.32 per share or total value of the company of BGN 133 mln. In the most optimistic version the price is BGN 12.59 with WACC of 10% and growth rate of 4%. In this case the total net value of the company amounts to BGN 314.8 mln.



Investors should pay special attention to the high sensitivity of the model depending on the revenue growth in 2010, when the company is expected to restore its results after the major correction in 2009. In 2010 we forecast a revenue growth of about 20%. Every 1% change in the growth in 2010 corresponds to 2.12% in the price level determined by our DCF model. If revenues in 2010 advance with 15% the price per share will be BGN 6.79 and if they rise with 10%, the price will be BGN 6.02.

**CONCLUSION**

**WE ARE POSITIVE ABOUT THE FUTURE DEVELOPMENT OF KAOLIN. ALTHOUGH OUR VALUATION OF SHARE PRICE OF KAOLIN IS ABOVE THE CURRENT MARKET LEVEL OUR RECOMMENDATION REMAINS *HOLD* SINCE WE CONSIDER THAT, DUE TO THE HIGH VOLATILITY OF FINANCIAL MARKETS, LOWER PRICES ARE VERY POSSIBLE IN SHORT-TERM PERIOD. THE COMPANY HAS A *BUY* POTENTIAL IN CASE OF CONTINUING MARKET DOWNTREND.**

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#### Information sources used

The information used in the preparation of this investment research has been taken from Company's public financial statements and the related enclosures as well as the Company's prospectus of public offering of securities, which are available on the web pages of the Bulgarian Stock Exchange - Sofia – [www.bse-sofia.bg](http://www.bse-sofia.bg) and the Financial Supervision Commission of the Republic of Bulgaria - [www.fsc.bg](http://www.fsc.bg), and the home page of the company, shown on the cover page hereof.

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