



UKR SPETS HOLDING

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# Investment Proposal



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## 1. MARKET OVERVIEW

Modern market of radiators in Ukraine is characterized by high growth rates and is still far away from saturation. This is primarily due to the need for total reconstruction of existing heating systems all across Ukraine as well as due to the high growth levels of construction industry. The demand for radiators comes from construction of new multistoried buildings, private houses and cottages, production industry (factory buildings, warehouses, office and retail buildings), as well as from overhaul of obsolete engineer networks which involves replacement of radiators.

One of the key market characteristic which determines the expediency of establishing manufacturing of radiators in Ukraine is market volume, in other words, its capacity to consume certain volume of goods per unit of time.

The calculation of market volume was based on two methods in order to get the results of market capacity.

- 1) Extrapolation of existing production for the future periods with allocation of a production share of steel panel radiators.

In the USSR annual production of heating equipment was over 26 million kW when import had symbolical value and didn't exceed 1%. The main share of radiators produced accounted for products made of cast iron about 70%, production of steel convectors both for general and special purpose use was equal to 20% and special place in the 8% market share was retained by steel panel radiators which, despite of thicker panels compared to convectors of foreign production, were offered for the use only in a limited number of regions with relatively good quality of network water.

**Table 1. Data used for calculations of radiators market volume in Ukraine on the basis of extrapolation of production figures of the previous periods.**

Indicator	Unit of measurement	Abbreviation	Value
Production of heating equipment in Post-Soviet states	Million kW	PHE	26
Percentage of Ukrainians of total population in Post-Soviet states	%	SUP	18.03
Thermal power of steel panel radiator used as a standard unit of measurement (class: 22d, size: 600x1000)	kW	TPS	1.92
Share of cast iron radiators of total production output of heating equipment	%	SIR	70
Share of general and special purpose convectors of the total production output of heating equipment	%	SOC	20
Share of steel radiators of the total production output of heating equipment	%	SSR	10
Retirement rate of iron radiators, annual share of iron radiators replaced with alternatives (formula 1)*	shares	RR*	0.208
Construction industry growth rate (according to the government of Ukraine)	shares	GRC	1.1



\*RR - Retirement rate of iron radiators is taken into account because of a considerable share of the latter in the structure of consumption in former USSR states, a significant growth potential for the steel panel radiators as a replacement of iron radiators.

RR corresponds to the annual share of retirement of existing iron radiators (produced in the USSR) which is connected with the reconstruction of accommodation and industrial premises (RAI), as well as with the taste preferences of consumers, supported by a paying capacity (TPC). The ratio is determined by index method (RAI, PC ≤1).

$$RR = RAI \times TPC$$

According to the planned state programs in 2012, 10% of residential and industrial funds are the subject for reconstruction that creates the potential for replacing iron radiators with the steel ones.

Ratio of consumer preferences (TPC) was determined on the basis of questioning of 1,021 customers of "Sandi-Plus", as well as its related parties. Please find questionnaire and the results of survey attached to this document (see Appendix 1). The analysis of the questionnaire results helped to identify 12% payment preference for steel radiators during replacement of the cast iron ones.

$$RR = (1 - 0.1) \times (1 - 0.12) = 0.792$$

$$RR = 0.792 \text{ equals retirement } (1 - 0.792) \times 100 = 20.8\% \text{ of cast iron radiators}$$

Share of cast iron radiators of the total production output of heating equipment is considered in terms of number of cast iron radiators which were installed and could be replaced. This is due to the fact that there is only one manufacturer of such type of heating equipment in Ukraine (CJSC "Lugansk Foundry - Mechanical Plant") which fully exports its products to the Russian Federation.

Percentage share of steel radiators produced in Ukraine of the total output of heating equipment is equal to 0 due to the fact that there is no domestic manufacturer while the share of other heating equipment manufactured in Ukraine is insignificant and can be neglected.

Market volume of steel panel radiators in Ukraine is based on the following calculations:

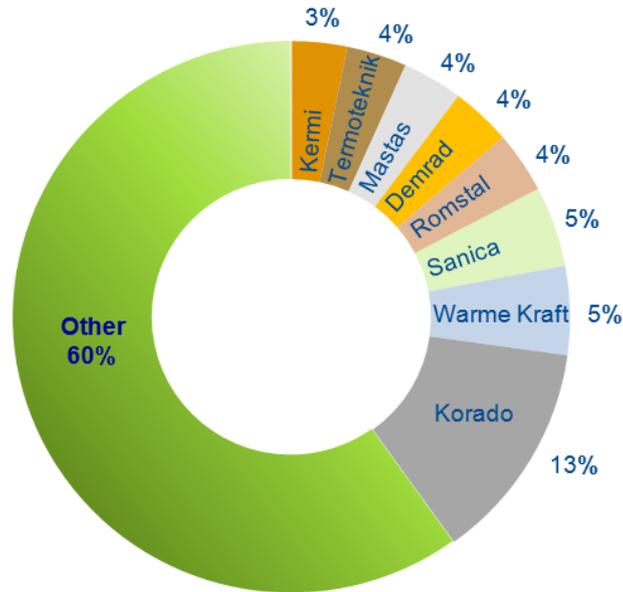
$$MV = \frac{PHE}{TPS} \times \frac{SUP}{100} \times \left( 1 + \frac{SIR}{100} \times RR + \frac{SOC}{100} \right) \times GRC$$

$$MV = \frac{26,000,000}{1.92} \times \frac{18.03}{100} \times \left( 1 + \frac{70}{100} \times 0.208 \right) \times 1.1 = 3,076,759.4 \text{ units}$$

MV – market volume of steel panel radiators in Ukraine of a standard type (class: 22, size: 600x1000).

## 2) Calculation of market volume based on official statistical data from the State Customs Service of Ukraine

The demand in Ukraine for steel panel radiators is partially satisfied with imported products: Kermi, Termoteknik, Demrad, Romstal, Sanica, Warme Kraft, Korado (60% of steel panel radiators market is held by small manufacturers and non-branded radiators see Figure 1).



**Figure 1. Allocation of import of steel radiators between manufacturers (Ukraine, 2011)**

According to the official statistical data total import of radiators in Ukraine was equal to 7,989,500 units.

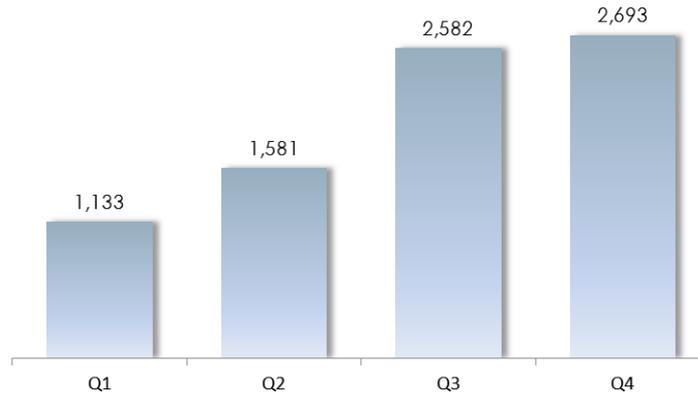
Import volume of radiators by quarter is presented in Figure 2 and reveals strong growth trend of import while Figure 3 represents the substantial growth of steel panel radiators over the period. This is due to the start of heating systems and sales slowdown of aluminum and bimetal radiators on the one hand and due to the ongoing construction of primary real estate, reconstruction of manufacturing facilities and partial construction of cottages on the other hand where the installation of steel radiators dominates for technological reasons. Furthermore, sharp increase in sales of steel radiators by the year-end is expected due to the payments from budget to construction companies which typically occur at the end of financial year.

Market volume calculation based on using the second method:

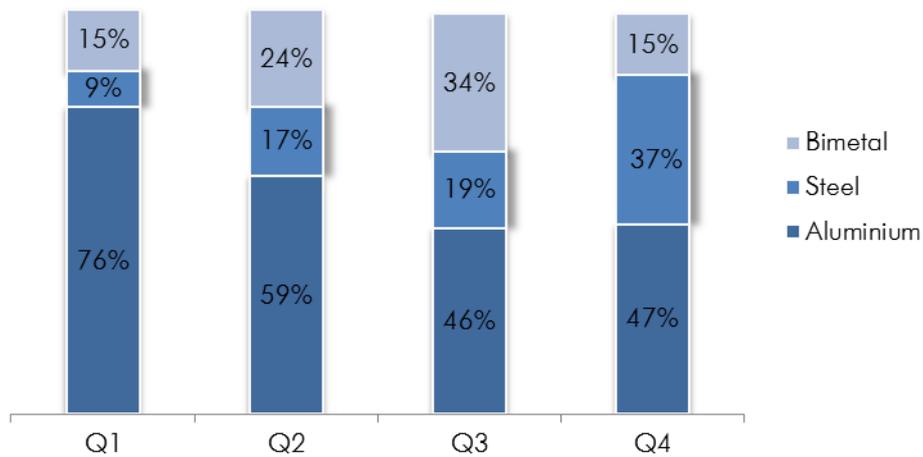
$$E' = \sum_{i=1}^4 T_i \times SSIR$$

$T_i$  – total imports of radiators to Ukraine in the  $i$ -quarter, thousands units;

$SSIR$  – percentage share of steel radiators of total imports volume in Ukraine in  $i$ -quarter.



**Figure 2. Allocation of imports of radiators by quarter (Ukraine, 2011)**



**Figure 3. Structural dynamics of imports of radiators by quarter (Ukraine, 2011)**

$$E' = 1,133 \times 0.09 \times 1,581 \times 0.13 \times 2,582 \times 0.19 \times 2,693 \times 0.37 = 1,794,490$$

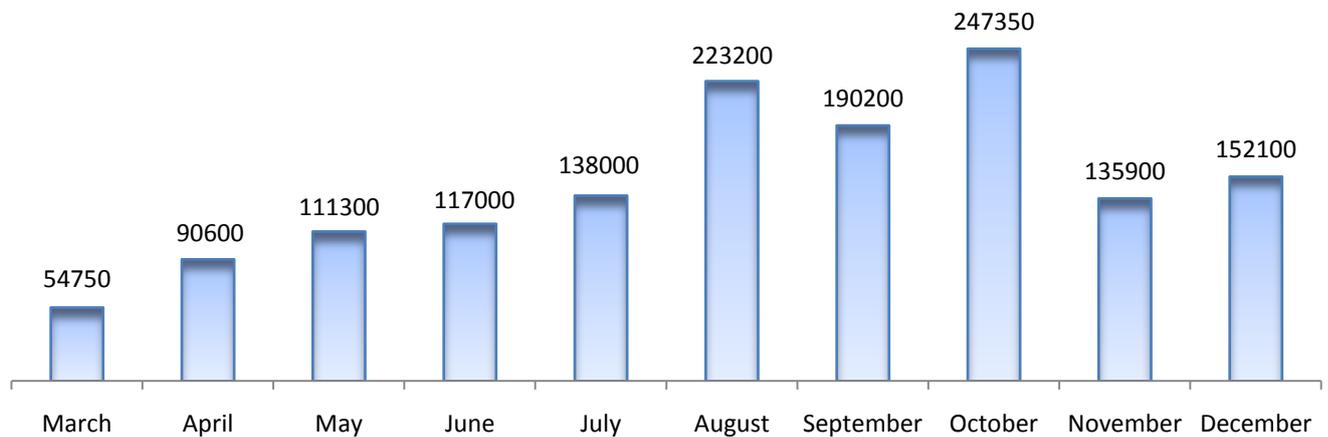
E' is calculated on the basis of official statistics which is known to represent less than half of the real commodity turnover. Therefore import substitution policy, as well as favorable customs, resource and marketing help would ensure the successful implementation of the project for manufacturing of steel panel radiators.

Customs statistics data for 2012 is presented in Table 2.



**Table 2. Dynamics of imports of steel panel radiators from Europe, Turkey and China to Ukraine.**

Month	Turkey, units	Share of Turkish radiators of the total import volume, %	Import from China, units	Share of Chinese radiators of the total import volume, %	Import of radiator from Europe, units	Share of European radiators of the total import volume, %	Total import volume, units
March	40,500	73.9	-	-	14,250	26.0	54,750
April	66,600	73.5	-	-	24,000	26.4	90,600
May	73,800	66.3	-	-	37,500	33.7	111,300
June	72,000	61.5	-	-	45,000	0.38	117,000
July	86,400	62.6	3,600	2.6	48,000	34.8	138,000
August	124,200	55.7			99,000	44.4	223,200
September	92,700	48.7			97,500	51.3	190,200
October	125,100	50.6			122,250	49.4	247,350
November	72,900	53.6			63,000	46.4	135,900
December	66,600	43.8			85,500	56.2	152,100
<b>Total</b>	<b>820,800</b>	<b>-</b>	<b>3,600</b>	<b>-</b>	<b>636,000</b>	<b>-</b>	<b>1,456,800</b>



**Figure 4. Dynamics of imports of steel panel radiators from Europe, Turkey and China to Ukraine by month in 2012, units**

Total import of steel radiators to Ukraine over the period which is not a high season for this type of product amounted to 1,456,800 units. The average value of import for the 10 months period was equal to 145,680 units, the capacity of Ukrainian market of steel panel radiators for 12 months of 2012 is 1,748,160 units which exceeds the production capacity of UKR SPETS HOLDING and can contribute to import substitution strategy of the company in delivering to the market of own products.



As a result of the performed calculations which were based on different approaches, we assume that the market can provide significant growth opportunities for UKR SPETS HOLDING which exceed the manufacturing capacity of the company and would provide free access to the market.

## 2. PRODUCT OVERVIEW

Steel panel radiators have recently become more popular: they are widely used in construction of multistoried buildings, private houses, office space and shopping malls which are being equipped with steel radiators. Popularity of steel heating radiators is caused by various factors, among which the main advantage is the ability to easily adjust the heat transfer agent temperature and room temperature. This makes it possible to save energy significant amount of energy by adjusting the temperature of a heat transfer system, which ultimately reduces the cost of heating. This advantage of steel radiators allows assigning them to the category of energy-efficient heating appliances. High level of heat emission of steel radiators is ensured by the design concept: heat is transferred by radiation from the outer panels and by the convection of the internal convector welded to the panel.

There are list of other advantages of steel radiators:

- modern design;
- low thermal inertia;
- wide variety of sizes and capacities;
- capacity of both side and bottom liner of heat transfer agent;
- easy to install.

There also some disadvantages that can be found in this type of heating equipment. First disadvantage of steel radiators is their sensitivity to oxygen in the heat transfer agent which can lead to corrosion. This deficiency can be easily removed if the heating system has an independent scheme of conjunction or has a good system for independent water conditioning connected to a central heating system. The second disadvantage is the increased corrosion of the material caused by the discharge of heat transfer agent from the radiator. This disadvantage is eliminated by installing valves in the radiator which provides the option to close the radiator and preserve heat transfer agent.

On the basis of market attractiveness parameters and competitive analysis of presented products in this market segment it is possible to describe the required technical characteristics as well as its positioning in a certain price category and against existing competitors.

Experts identify three price categories of base model of the radiator (class: 22, size 600×1000), see Table 3.

**Table 3. Price categories of steel radiators in the market**

Price category	Presented brands
 High 660-770 UAH	Korado, Kermi, Vogel&Noot, Purmo
 Medium 500-550	Daylux, Grandini
 Low 460-480 UAH	Emko, Sanica, Radimir



Price positioning of steel radiators of UKR SPETS HOLDING™ is assumed to be in the medium price category. The target market for new type of radiators manufactured by UKR SPETS HOLDING would be large as well as small construction companies that would use steel panel radiators within the construction projects including but not limited to building of new houses and renovation of existing ones and manufacturing facilities. Moreover, company “Sandi Plus” which is a co-founder of UKR SPETS HOLDING has a nationwide distribution chain and focuses its business activities on sale of sanitary ware.

There are a number of Agreements of intent with dealers of the company “Sandi Plus” in regard to the sales volume of steel panel radiators of UKR SPETS HOLDING™. Besides, the price of the steel panel radiator manufactured by UKR SPETS HOLDING and its qualitative characteristics satisfy the requirements of tenders that are run among the construction companies.

Successful implementation of the project in Ukraine is possible due to two key factors: the absence of a similar domestic manufacturer (slide 8) and high cost of customs clearance of goods to Ukraine (slide 9).

### 3. OWNERSHIP STRUCTURE

Investments are being attracted by UKR SPETS HOLDING founded by “Sandi Plus” and several private investors.

Sandi Plus was founded in 2000 and expanded into sanitary ware wholesaler. It is the authorized reseller of 9 brands (including 3 private labels). Sandi Plus has its own nationwide distribution chain including 8 sales representatives and 26 dealers, 7 shops, 7,000 m2 of modern warehouse space, 15 vehicles.

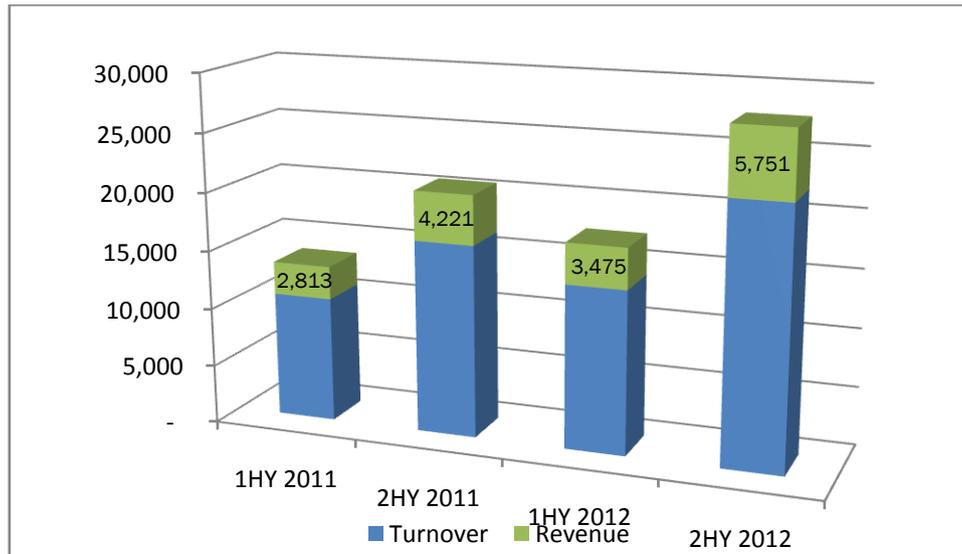
Total number of employees is 128 people, including:

- Management – 19;
- Administrative staff – 5;
- Security service – 10;
- IT-staff – 4;
- Accountants – 11;
- Sales staff – 60;
- Service personnel (storekeepers, drivers, electricians) – 19.

Sandi Plus company has an extensive network of offices all across Ukraine including Dnipropetrovsk, Zhytomyr, Ivano-Frankivsk, Lviv, Mykolayiv, Poltava, Simferopol, Kherson.

Company “Sandi Plus” ([www.sandiplus.com.ua](http://www.sandiplus.com.ua)) is the official representative of such brands: Blue Ocean (<http://www.boig.org/>, <http://boig.com.ua/>), ICMA (<http://www.icmaspa.it/>, <http://icma.com.ua/>), Radiatori 2000 (<http://www.radiatori2000.it/>), Airfel Daylux (<http://www.airfel.com.tr/>), Interplast (<http://interplast.dn.ua/>), Bianchi rubinetteria (<http://www.bianchisanitari.com/>), Hansa (<http://www.hansa.com/>), Oras (<http://www.oras.com/>), Zigor (<http://www.zigor.com/>).

Moreover, company “Sandi Plus” is a developer of private brands: Touch-Z (<http://touch-z.com.ua/>), Q-Tap, SanDi-Flex, Imperial.



**Figure 5. Sandi Plus financial results for the period 1HY 2011-1HY 2012, 000'EUR**

Company “Sandi Plus” has dealership agreements with 26 partners that provides distribution of their products in the specified geographic regions according to the fixed price policy, as well as realization of specified sales.

#### 4. INVESTMENT PROPOSAL

Total funding of the project equals to €21.3 m which would be financed by the founder SandiPlus in the amount of €11.8 m (55%) (see Slide 12). UKR SPETS HOLDING is currently seeking for an investor who can provide a loan in the amount of €9.5 m. These funds will be used to finance acquisition and development of 2 manufacturing lines. Structure of the loan is shown on the slide 12 and involves the breakdown of the loan into three equal installments in the amount of €3,161,667. The first installment is needed for the 9 months before the launch of manufacturing process as an advance payment for the production line, the second installment is needed at the start of the manufacturing to repay the cost of the manufacturing line and as an advance payment for the double increase in production capacity. The third installment is needed at the fourth month after the launch of production for the redemption value of the second manufacturing line.

Annual interest rate equals 6% per year, loan repayment period 14 months, repayment in equal installments in the amount of €677,500 with the deferred start of repayment of 7 months since the start of manufacturing process.

Profitability of manufactured product was evaluated at 50%, internal rate of return 36% per year, net present value equals €10.8 m.

Sales of steel heating radiators offer attractive opportunities for profit growth which would be used for loan repayment and forecasted to be generated in the 2nd month of active radiators sales.

Slide 16: the team consist of a manager of the project, “Sandi Plus” company director, who has more than 15 years of managerial experience in sanitary ware wholesale; Marketing Director, who has over 14 years of experience in business analytics, author of the successful projects; technical support – over 18 years of experience in machinery construction in such areas as welding and organization of mass production.