

**Research**  
June 23, 2009

**Oil and gas**  
**Russia**

# LUKOIL

*Saving and optimizing*

**Recommendation: BUY**

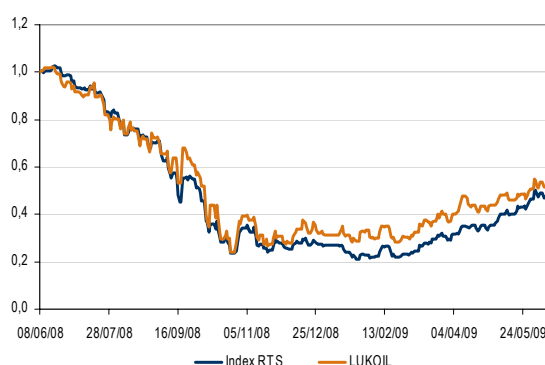
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## Bullet moments

- ◆ Evaluating LUKOIL's results of 1Q 2009 by US GAAP we should outline the company's profitability recovery versus the losing 4Q 2008. That was thanks to the effort of the company's management on optimizing business processes and saving on behalf of the principal production operations. So, the expenses of extraction returned to the level of 2006. (3.1 USD per extracted barrel), expenses of processing at the company's own refineries formed 2.03 USD per barrel. That was also supported by the devaluation of ruble that occurred and work with the contractors on reducing the price of the services being provided.
- ◆ Along with that in 1Q 2009 the company has built up the oil extraction (+3.2% versus 1Q 2008), which we assume will reflect positively of the company's finance. Also LUKOIL conducted diversification of supplies of its products (oil export upped by 17%, oil products export – by 3.9%), which we believe is due to the raise of export margin and the launch of supplying oil to the refinery, purchased in Italy.
- ◆ We included all the changes on the product distribution markets in our model and also we have insignificantly corrected up the forecast of oil extraction within the current and the following years. Decrease of gas extraction by 11.2% in 2009 will occur mainly on behalf of the Russian segment and due to limitation of gas intake by Gazprom, which in its turn has been caused by the demand lowering for the given energy carrier. Also we have corrected down the selling price of the "blue fuel" due to the same reasons. We assume the recovery of gas direction in LUKOIL and other independent producers might be expected no sooner than mid next year.
- ◆ In our model of LUKOIL we detailed the distribution prices of the company's products at both: domestic and foreign markets. At the same time we did not change the long-term forecast of the oil prices. For the current year we suppose the average price of Urals will form 50-56 USD per barrel.
- ◆ In our model of LUKOIL we considered the current extension of the company's retail network and also the plans of further expansion to the retail market of the oil products.
- ◆ As a result of corrections of the model, the new fair value of LUKOIL's shares formed 77.06 USD versus 72.77 USD, forecasted earlier (5.9% higher). Due to the significant growth potential, which forms more than 40%, we confirm our recommendation BUY for the shares of the company.

## Principal estimates

Company's shares dynamics vs RTS



### Company profile

RTS ticker	LUKOH
Last price, USD	54.20
Min / max price for 52 weeks, USD	24,90 / 105,3
Target price (end of the year), USD	77,06
Upside (downside), %	42,18
Shares outstanding	850 563 255
Market capitalization, mn USD	46 101
EV, mn USD	53 671

### Financial highlights (GAAP)

	2008	2009(F)	2010(F)
Sales, mn USD	107 680	64 786	85 139
EBITDA, mn USD	16 667	11 940	15 036
Net profit, mn USD	9 144	5 926	8 880
EBITDA margin, %	15,5	18,4	17,7
Net profit margin, %	8,5	9,1	10,4
ROIC, %	21,1	10,9	13,5

### Multipliers

	2008	2009(F)	2010(F)
P/E	5,0	7,8	5,2
P/S	0,43	0,71	0,54
P/BV	0,9	0,8	0,7
EV/S	0,5	0,8	0,6
EV/EBITDA	3,2	4,5	3,6
EV/IC	0,9	0,8	0,8
ROIC/WACC	1,2	0,7	0,9

## Financial model

### LUKOIL's oil extraction and sales of oil and petrochemicals, 2007-2017

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>Oil extraction mn tons</b>											
Crude oil produced in Russia	90,7	89,6	92,6	93,9	95,8	98,7	101,7	104,7	107,9	111,6	115,5
Crude oil produced internationally	3,4	3,2	3,3	3,4	3,4	3,5	3,6	3,7	3,8	4,0	4,1
Share in crude oil produced by equity affiliates	2,5	2,4	2,5	2,5	2,6	2,6	2,7	2,8	2,9	3,0	3,1
<b>Gas extraction, bn cb m</b>	14,0	17,0	15,1	18,1	23,6	28,3	32,5	37,4	43,0	47,3	52,1
<b>Crude oil and petroleum products purchases, mn tons</b>											
Crude oil purchases in Russia	0,0	0,2	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
Crude oil purchases internationally	4,5	10,4	17,0	17,0	16,8	16,7	16,5	16,3	16,2	16,0	15,8
Petroleum products purchases in Russia	1,5	1,6	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4
Petroleum products purchases internationally	38,7	38,7	37,2	37,5	37,8	37,9	38,0	38,2	38,5	38,7	38,8
<b>Oil sales, mn tons</b>											
Export and sales at international markets	39,4	37,4	50,3	46,9	43,9	44,8	46,6	45,7	44,5	43,1	44,8
including CIS market exports and sales	2,7	4,3	5,8	5,4	5,1	5,2	5,4	5,3	5,1	5,0	5,2
Domestic market sales	1,6	2,1	1,1	1,0	1,0	1,0	1,0	0,9	0,9	0,9	0,9
<b>Petroleum products sales, mn tons</b>											
Export and sales on international markets:											
Wholesale	64,4	67,7	68,9	73,3	76,8	79,2	80,0	83,0	86,3	90,3	92,0
Retail	7,9	8,2	8,4	8,9	9,3	9,6	9,7	10,1	10,5	10,9	11,1
Domestic sales:											
Wholesale	13,7	13,3	13,1	13,9	14,6	15,0	15,2	15,8	16,4	17,1	17,5
Retail	4,9	6,0	5,9	6,2	6,5	6,7	6,8	7,1	7,3	7,7	7,8
<b>Petrochemicals mn tons:</b>											
Export and sales on international markets	1,4	1,0	0,8	0,8	1,2	1,2	1,2	1,3	1,4	1,5	1,5
Domestic sales	0,7	0,7	0,5	0,6	0,8	0,8	0,8	0,9	0,9	1,0	1,0

Source: company's data; Estimation: Veles Capital

### Sales price of oil and oil products forecast for LUKOIL, 2007-2017

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>External market</b>											
Brent oil price, USD/bbl.	72,8	97,8	50,6	65,2	73,2	80,1	88,6	92,7	95,6	95,2	95,2
Urals oil price (CIF Mediterranean region), USD/bbl.	69,5	94,8	49,0	63,1	70,9	77,6	85,8	89,8	92,6	92,2	92,2
Oil sales price (IM), USD/t	500,0	675,7	349,4	450,1	505,6	553,4	612,0	640,4	660,6	657,5	657,5
Oil sales price (CIS), USD/t	336,2	376,6	262,2	304,0	341,5	373,7	413,3	432,5	446,1	444,0	444,0
Petroleum products sales price, USD/t (IM):											
Wholesale	589,7	747,1	400,1	515,4	578,9	633,6	700,7	733,2	756,4	752,8	752,8
Retail	1 160,9	1 462,1	1 054,7	1 304,2	1 465,0	1 603,4	1 773,3	1 855,5	1 914,2	1 905,1	1 905,1
Average realized price of petrochemicals USD/t	1 082,8	1 202,9	435,4	560,9	630,0	689,5	762,6	797,9	823,2	819,3	819,3
<b>Internal market</b>											
Oil sales price, USD/t	274,4	285,7	151,4	195,0	219,1	239,8	265,2	277,5	286,3	284,9	284,9
Petroleum products sales price, USD/t:											
Wholesale	427,7	604,6	347,0	447,0	502,1	549,5	607,7	635,9	656,0	652,9	652,9
Retail	766,7	976,4	666,5	824,2	925,8	1 013,2	1 120,6	1 172,5	1 209,6	1 203,9	1 203,9
Average realized price of petrochemicals USD/t	1 023,7	1 257,1	455,0	586,2	658,4	720,6	797,0	833,9	860,3	856,2	856,2

Source: company's data; Estimation: Veles Capital

### Sales of products by LUKOIL, 2007-2017, mn USD

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>Oil</b>											
Export and sales at international markets	18 346	22 382	15 545	18 694	19 640	21 939	25 248	25 889	26 012	25 057	26 040
CIS market exports and sales	912	1 625	1 520	1 645	1 728	1 930	2 221	2 278	2 289	2 205	2 291
Domestic market sales	440	600	164	204	222	238	257	264	266	260	256
<b>Petroleum products</b>											
Export and sales on international markets:											
Wholesale	37 971	50 553	27 578	37 753	44 452	50 159	56 071	60 880	65 287	67 950	69 250
Retail	9 183	11 989	8 809	11 577	13 631	15 382	17 194	18 669	20 020	20 837	21 236
Domestic sales:											
Wholesale	5 862	8 049	4 539	6 213	7 316	8 255	9 228	10 020	10 745	11 183	11 397
Retail	3 721	5 823	3 905	5 132	6 042	6 818	7 622	8 275	8 874	9 236	9 413
<b>Sum</b>	<b>75 522</b>	<b>101 021</b>	<b>62 061</b>	<b>81 217</b>	<b>93 031</b>	<b>104 722</b>	<b>117 842</b>	<b>126 274</b>	<b>133 493</b>	<b>136 728</b>	<b>139 883</b>
<b>Petrochemicals:</b>											
Export and sales on international markets	1 569	1 232	336	469	738	833	938	1 037	1 133	1 202	1 235
Domestic sales	733	880	240	335	527	595	670	741	809	858	882
<b>Other domestic sales</b>	<b>1 644</b>	<b>2 913</b>	<b>1 277</b>	<b>1 977</b>	<b>3 167</b>	<b>4 693</b>	<b>6 385</b>	<b>7 549</b>	<b>8 924</b>	<b>10 082</b>	<b>10 912</b>
<b>Other sales on international markets</b>	<b>1 512</b>	<b>1 634</b>	<b>873</b>	<b>1 141</b>	<b>1 307</b>	<b>1 474</b>	<b>1 679</b>	<b>1 809</b>	<b>1 922</b>	<b>1 980</b>	<b>2 049</b>
<b>Sales, Total</b>	<b>80 979</b>	<b>107 680</b>	<b>64 786</b>	<b>85 139</b>	<b>98 771</b>	<b>112 316</b>	<b>127 513</b>	<b>137 411</b>	<b>146 280</b>	<b>150 849</b>	<b>154 962</b>

Source: company's data; Estimation: Veles Capital

**LUKOIL's balance sheets, 2007-2017, mn USD**

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>Assets</b>											
<b>Current assets</b>	17 903	15 633	16 165	21 340	25 981	32 432	38 995	45 308	51 475	57 152	62 261
Cash and cash equivalents	841	2 239	1 347	1 472	1 938	2 160	2 386	2 637	2 786	2 864	2 956
Short-term investments	48	505	1 553	3 523	5 171	8 881	12 352	16 567	20 884	25 575	29 720
Accounts and notes receivable, net	7 467	5 069	5 877	7 107	8 245	9 376	10 645	11 471	12 212	12 593	12 936
Inventories	4 609	3 735	4 027	5 269	6 022	6 779	7 669	8 228	8 775	9 089	9 426
Prepaid taxes and other expenses	4 109	3 566	2 856	3 304	3 833	4 359	4 949	5 333	5 677	5 855	6 014
Other current assets	625	519	505	664	770	876	994	1 072	1 141	1 176	1 208
Assets held for sale	204	0	0	0	0	0	0	0	0	0	0
<b>Long-term assets</b>	41 729	55 828	58 846	62 515	67 317	73 212	80 420	87 997	95 818	103 063	109 957
Investments	1 086	3 269	3 269	3 269	3 269	3 269	3 269	3 269	3 269	3 269	3 269
Property, plant and equipment	37 930	50 088	53 081	56 623	61 347	67 160	74 269	81 786	89 551	96 775	103 649
Deferred income tax assets	490	521	507	666	773	879	998	1 076	1 145	1 181	1 213
Goodwill and other intangible assets	934	1 159	1 198	1 165	1 137	1 113	1 093	1 076	1 061	1 048	1 035
Other non-current assets	1 289	791	791	791	791	791	791	791	791	791	791
<b>Total assets</b>	<b>59 632</b>	<b>71 461</b>	<b>75 011</b>	<b>83 854</b>	<b>93 298</b>	<b>105 644</b>	<b>119 416</b>	<b>133 305</b>	<b>147 293</b>	<b>160 215</b>	<b>172 218</b>
<b>Liabilities</b>											
<b>Current liabilities</b>	9 728	10 575	9 266	10 294	10 884	11 673	12 745	13 434	14 092	14 411	14 717
Accounts payable	4 554	5 029	4 228	5 556	6 445	7 329	8 321	8 967	9 546	9 844	10 112
Short-term borrowings and current portion of long-term debt	2 214	3 232	2 909	1 939	1 293	862	575	383	255	170	113
Taxes payable	2 042	1 564	1 439	1 892	2 093	2 285	2 491	2 620	2 733	2 790	2 840
Other current liabilities	918	750	690	907	1 052	1 197	1 359	1 464	1 559	1 607	1 651
<b>Long-term liabilities</b>	8 691	10 546	11 098	11 153	10 639	10 995	11 368	11 440	11 498	11 407	11 309
Long-term debt	4 829	6 577	7 104	6 165	4 873	4 418	3 876	3 206	2 536	1 867	1 197
Deferred income tax liabilities	2 079	2 116	2 004	2 633	3 055	3 474	3 944	4 250	4 524	4 665	4 792
Asset retirement obligations	811	718	718	718	718	718	718	718	718	718	718
Other long-term liabilities	395	465	428	562	652	742	842	908	966	996	1 024
Minority interest in subsidiary companies	577	670	845	1 074	1 341	1 644	1 988	2 359	2 753	3 160	3 578
<b>Total liabilities</b>	<b>18 419</b>	<b>21 121</b>	<b>20 364</b>	<b>21 447</b>	<b>21 523</b>	<b>22 668</b>	<b>24 113</b>	<b>24 874</b>	<b>25 590</b>	<b>25 817</b>	<b>26 026</b>
<b>Stockholders' equity</b>	<b>41 213</b>	<b>50 340</b>	<b>54 646</b>	<b>62 408</b>	<b>71 775</b>	<b>82 976</b>	<b>95 303</b>	<b>108 431</b>	<b>121 703</b>	<b>134 398</b>	<b>146 192</b>
Common stock	15	15	15	15	15	15	15	15	15	15	15
Treasury stock, at cost	(1 591)	(282)	(282)	(282)	(282)	(282)	(282)	(282)	(282)	(282)	(282)
Additional paid-in capital	4 499	4 694	4 720	4 720	4 720	4 720	4 720	4 720	4 720	4 720	4 720
Retained earnings	38 349	45 983	50 262	58 024	67 391	78 592	90 919	104 047	117 319	130 014	141 808
Accumulated other comprehensive loss	(59)	(70)	(69)	(69)	(69)	(69)	(69)	(69)	(69)	(69)	(69)
<b>Total liabilities and stockholders' equity</b>	<b>59 632</b>	<b>71 461</b>	<b>75 011</b>	<b>83 854</b>	<b>93 298</b>	<b>105 644</b>	<b>119 416</b>	<b>133 305</b>	<b>147 293</b>	<b>160 215</b>	<b>172 218</b>

Source: company's data; Estimation: Veles Capital

**Financial model of LUKOIL, 2007-2017, mn USD**

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>Revenues</b>	<b>81 891</b>	<b>107 680</b>	<b>64 786</b>	<b>85 139</b>	<b>98 771</b>	<b>112 316</b>	<b>127 513</b>	<b>137 411</b>	<b>146 280</b>	<b>150 849</b>	<b>154 962</b>
Operating expenses	(6 172)	(8 126)	(6 563)	(7 570)	(8 652)	(9 700)	(10 730)	(11 899)	(13 188)	(14 562)	(15 719)
Crude oil, petroleum and other products purchased	(27 982)	(37 851)	(21 056)	(27 289)	(30 745)	(33 637)	(37 153)	(38 938)	(40 239)	(40 143)	(40 125)
Transportation expenses	(4 457)	(5 460)	(5 166)	(6 618)	(7 659)	(8 912)	(9 959)	(11 301)	(13 560)	(15 342)	(16 950)
Selling, general and administrative expenses	(3 207)	(3 860)	(3 091)	(4 062)	(4 713)	(5 359)	(6 084)	(6 604)	(7 072)	(7 735)	(7 946)
Taxes other than income taxes	(9 367)	(13 464)	(5 976)	(8 329)	(9 820)	(11 296)	(13 104)	(14 263)	(15 275)	(15 773)	(16 359)
Excise and export duties	(15 033)	(21 340)	(10 705)	(15 843)	(18 384)	(21 278)	(25 138)	(26 407)	(27 125)	(26 660)	(27 234)
Other	(430)	(912)	(289)	(391)	(475)	(565)	(672)	(757)	(843)	(908)	(974)
<b>EBITDA</b>	<b>15 243</b>	<b>16 667</b>	<b>11 940</b>	<b>15 036</b>	<b>18 323</b>	<b>21 568</b>	<b>24 674</b>	<b>27 243</b>	<b>28 978</b>	<b>29 725</b>	<b>29 655</b>
<b>EBITDA margin, %</b>	<b>18,6</b>	<b>15,5</b>	<b>18,4</b>	<b>17,7</b>	<b>18,6</b>	<b>19,2</b>	<b>19,3</b>	<b>19,8</b>	<b>19,8</b>	<b>19,7</b>	<b>19,1</b>
Depreciation, depletion and amortization	(2 172)	(2 958)	(3 914)	(4 162)	(4 435)	(4 800)	(5 250)	(5 800)	(6 382)	(6 983)	(7 542)
<b>EBIT</b>	<b>13 071</b>	<b>13 709</b>	<b>8 026</b>	<b>10 874</b>	<b>13 887</b>	<b>16 768</b>	<b>19 424</b>	<b>21 443</b>	<b>22 596</b>	<b>22 742</b>	<b>22 112</b>
<b>EBIT margin, %</b>	<b>16,0</b>	<b>12,7</b>	<b>12,4</b>	<b>12,8</b>	<b>14,1</b>	<b>14,9</b>	<b>15,2</b>	<b>15,6</b>	<b>15,4</b>	<b>15,1</b>	<b>14,3</b>
Non-operating income/expense	(53)	(1 343)	(572)	296	(94)	116	(109)	(116)	(74)	(68)	51
<b>Income before provision for income taxes</b>	<b>13 018</b>	<b>12 366</b>	<b>7 454</b>	<b>11 170</b>	<b>13 794</b>	<b>16 883</b>	<b>19 315</b>	<b>21 326</b>	<b>22 522</b>	<b>22 674</b>	<b>22 163</b>
<b>Income before taxes margin, %</b>	<b>15,9</b>	<b>11,5</b>	<b>11,5</b>	<b>13,1</b>	<b>14,0</b>	<b>15,0</b>	<b>15,1</b>	<b>15,5</b>	<b>15,4</b>	<b>15,0</b>	<b>14,3</b>
Income tax	(3 507)	(3 222)	(1 528)	(2 290)	(2 828)	(3 461)	(3 960)	(4 372)	(4 617)	(4 648)	(4 543)
<b>Net income</b>	<b>9 511</b>	<b>9 144</b>	<b>5 926</b>	<b>8 880</b>	<b>10 966</b>	<b>13 422</b>	<b>15 355</b>	<b>16 954</b>	<b>17 905</b>	<b>18 026</b>	<b>17 620</b>
<b>Net income margin, %</b>	<b>11,6</b>	<b>8,5</b>	<b>9,1</b>	<b>10,4</b>	<b>11,1</b>	<b>12,0</b>	<b>12,0</b>	<b>12,3</b>	<b>12,2</b>	<b>11,9</b>	<b>11,4</b>

Source: company's data; Estimation: Veles Capital

**LUKOIL's consolidated statements of cash flows, 2007-2017, mn USD**

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>Operating activities</b>											
Net income	9 511	9 144	5 926	8 880	10 966	13 422	15 355	16 954	17 905	18 026	17 620
<b>Nonmonetary item corrections</b>											
Depreciation, depletion and amortization	2 172	2 958	3 914	4 162	4 435	4 800	5 250	5 800	6 382	6 983	7 542
Other corrections, net	1 026	(489)	69	91	105	120	136	146	156	161	165
<b>Changes in assets and liabilities</b>											
Changes of turnover assets	(3 629)	4 377	(362)	(3 239)	(2 633)	(2 625)	(2 986)	(1 924)	(1 771)	(944)	(904)
Changes of turnover liabilities	1 801	(1 678)	(1 135)	2 761	1 748	1 728	1 930	1 252	1 119	575	517
<b>Net cash provided by operating activities</b>	<b>10 881</b>	<b>14 312</b>	<b>8 412</b>	<b>12 655</b>	<b>14 622</b>	<b>17 446</b>	<b>19 686</b>	<b>22 228</b>	<b>23 791</b>	<b>24 801</b>	<b>24 941</b>
<b>Investing activities</b>											
Acquisition of licenses	(255)	(12)	(14)	(16)	(18)	(21)	(23)	(26)	(29)	(32)	(35)
Capital expenditures	(9 071)	(10 525)	(6 573)	(7 274)	(8 655)	(10 035)	(11 691)	(12 600)	(13 388)	(13 446)	(13 646)
(Purchase)/sale of short-term financial investments	(31)	238	(1 048)	(1 970)	(1 648)	(3 710)	(3 471)	(4 215)	(4 317)	(4 691)	(4 146)
Other, (purchase)/sale of investments	(358)	(3 260)	(428)	(474)	(563)	(653)	(761)	(820)	(872)	(875)	(888)
<b>Net cash used in investing activities</b>	<b>(9 715)</b>	<b>(13 559)</b>	<b>(8 063)</b>	<b>(9 733)</b>	<b>(10 885)</b>	<b>(14 419)</b>	<b>(15 946)</b>	<b>(17 661)</b>	<b>(18 605)</b>	<b>(19 045)</b>	<b>(18 714)</b>
<b>Financing activities</b>											
Proceeds/(repayments) from short-term borrowings	(59)	974	(323)	(970)	(646)	(431)	(287)	(192)	(128)	(85)	(57)
Proceeds from issuance of long-term debt	2 307	2 884	1 458	0	0	0	0	0	0	0	0
Principal repayments of long-term debt	(1 632)	(1 547)	(931)	(939)	(1 292)	(455)	(542)	(670)	(670)	(670)	(670)
Dividends paid	(1 230)	(1 437)	(1 445)	(889)	(1 332)	(1 919)	(2 684)	(3 455)	(4 239)	(4 924)	(5 408)
Dividends paid to minority	(78)	(168)	0	0	0	0	0	0	0	0	0
Other – net	(406)	57	0	0	0	0	0	0	0	0	0
<b>Net cash used in financing activities</b>	<b>(1 098)</b>	<b>763</b>	<b>(1 241)</b>	<b>(2 797)</b>	<b>(3 270)</b>	<b>(2 805)</b>	<b>(3 514)</b>	<b>(4 316)</b>	<b>(5 036)</b>	<b>(5 679)</b>	<b>(6 134)</b>
Effect of exchange rate changes on cash and cash equivalents	21	(118)	0	0	0	0	0	0	0	0	0
<b>Change in cash and cash equivalents</b>	<b>89</b>	<b>1 398</b>	<b>(892)</b>	<b>125</b>	<b>467</b>	<b>222</b>	<b>226</b>	<b>251</b>	<b>149</b>	<b>78</b>	<b>92</b>
Cash and cash equivalents as of the beginning of the year	752	841	2 239	1 347	1 472	1 938	2 160	2 386	2 637	2 786	2 864
<b>Cash and cash equivalents as of the end of the year</b>	<b>841</b>	<b>2 239</b>	<b>1 347</b>	<b>1 472</b>	<b>1 938</b>	<b>2 160</b>	<b>2 386</b>	<b>2 637</b>	<b>2 786</b>	<b>2 864</b>	<b>2 956</b>

Source: company's data; Estimation: Veles Capital

## Fair price estimation

### Weighted average cost of capital estimation (WACC), %

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>Cost of equity (ks)</b>	<b>10,38</b>	<b>18,71</b>	<b>18,19</b>	<b>16,65</b>	<b>14,55</b>	<b>12,99</b>	<b>12,99</b>	<b>12,99</b>	<b>12,99</b>	<b>12,99</b>	<b>12,99</b>
Risk-free rate, %	4,78	7,84	10,01	9,01	8,01	7,53	7,53	7,53	7,53	7,53	7,53
10 year US Treasuries yield, %	3,76	4,32	3,41	3,41	3,41	3,41	3,41	3,41	3,41	3,41	3,41
RF' default spread, %	1,02	3,52	6,60	5,60	4,60	4,13	4,13	4,13	4,13	4,13	4,13
Expected market return, %	5,00	10,00	7,50	7,00	6,00	5,00	5,00	5,00	5,00	5,00	5,00
βL coefficient (according to financial leverage)	1,120	1,087	1,091	1,091	1,091	1,091	1,091	1,091	1,091	1,091	1,091
Premium for the quality of corporate governance, %	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Source fraction: own capital, %	85,4	83,7	84,5	88,5	92,1	94,0	95,5	96,8	97,8	98,5	99,1
<b>Cost of debt (kd)</b>	<b>6,00</b>	<b>12,00</b>	<b>10,50</b>	<b>9,50</b>	<b>8,25</b>	<b>7,75</b>	<b>7,75</b>	<b>7,75</b>	<b>7,75</b>	<b>7,75</b>	<b>7,75</b>
Risk-free rate, %	4,78	7,84	10,01	9,01	8,01	7,53	7,53	7,53	7,53	7,53	7,53
Premium for credit risk, %	1,22	4,16	0,49	0,49	0,24	0,22	0,22	0,22	0,22	0,22	0,22
Tax rate, %	26,50	26,05	20,50	20,50	20,50	20,50	20,50	20,50	20,50	20,50	20,50
Source fraction: borrowed capital, %	14,60	16,31	15,49	11,49	7,91	5,98	4,46	3,20	2,24	1,49	0,89
<b>WACC</b>	<b>9,51</b>	<b>17,10</b>	<b>16,67</b>	<b>15,60</b>	<b>13,92</b>	<b>12,58</b>	<b>12,68</b>	<b>12,77</b>	<b>12,83</b>	<b>12,89</b>	<b>12,93</b>

Source: company's data: Estimation: Veles Capital

### Free Cash Flow of LUKOIL, forecast, 2007-2017, mn USD

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
<b>EBITDA</b>	<b>15 243</b>	<b>16 667</b>	<b>11 940</b>	<b>15 036</b>	<b>18 323</b>	<b>21 568</b>	<b>24 674</b>	<b>27 243</b>	<b>28 978</b>	<b>29 725</b>	<b>29 655</b>
Amortization and depreciation	2 172	2 958	3 914	4 162	4 435	4 800	5 250	5 800	6 382	6 983	7 542
EBIT	13 071	13 709	8 026	10 874	13 887	16 768	19 424	21 443	22 596	22 742	22 112
Income tax	(3 464)	(3 572)	(1 645)	(2 229)	(2 847)	(3 437)	(3 982)	(4 396)	(4 632)	(4 662)	(4 533)
NOPAT	9 607	10 137	6 381	8 645	11 041	13 330	15 442	17 047	17 964	18 080	17 579
CapEx	9 684	13 797	7 015	7 763	9 236	10 709	12 475	13 446	14 289	14 354	14 569
Change in working capital	(1 828)	2 699	(1 497)	(478)	(885)	(897)	(1 056)	(672)	(652)	(369)	(386)
<b>FCF</b>	<b>267</b>	<b>1 997</b>	<b>1 783</b>	<b>4 566</b>	<b>5 354</b>	<b>6 525</b>	<b>7 161</b>	<b>8 728</b>	<b>9 405</b>	<b>10 341</b>	<b>10 166</b>

Source: company's data: Estimation: Veles Capital

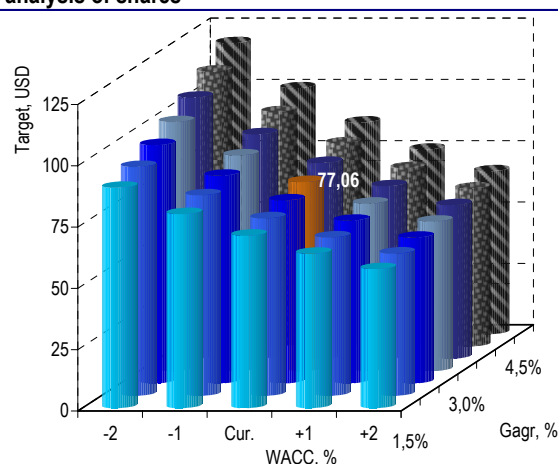
### LUKOIL's stocks valuation

TGR, %	3,00
Discount rate, %	12,93
Discounted cash flow amount, mn USD	34 704
Terminal value, mn USD	105 480
Discounted terminal value, mn USD	39 882
Enterprise value, mn USD	74 586
Net debt, mn USD	8 666
Minority interest, mn USD	670
Shareholder's equity, mn USD	65 250
Number of shares, mn units	850 563 255
Fair value of common stock at the year end, USD	77,06
Upside (downside) of common stock, %	42,18

Source: company's data: Estimation: Veles Capital

### Average fair price analysis of shares

Growth rate in postforecasted period, %	WACC, %				
	-2	-1	Cur.	+1	+2
1,5%	89,8	79,1	70,3	62,9	56,7
2,0%	93,3	81,7	72,3	64,5	58,0
2,5%	97,1	84,6	74,6	66,3	59,4
3,0%	101,5	87,9	77,1	68,2	60,9
3,5%	106,4	91,5	79,8	70,4	62,6
4,0%	112,1	95,6	82,8	72,7	64,4
4,5%	118,6	100,2	86,3	75,3	66,4



Estimation: Veles Capital

## Financial analysis

### Value forming estimates

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
Invested capital growth (IC), %	23,5	22,1	9,5	9,3	10,3	13,4	13,2	12,5	11,4	9,9	8,3
Invested capital (IC), mn USD	47 992	58 580	64 157	70 115	77 344	87 739	99 355	111 742	124 462	136 731	148 124
Equity, mn USD	41 213	50 340	54 646	62 408	71 775	82 976	95 303	108 431	121 703	134 398	146 192
EVA spread (ROIC-WACC), %	15,2	4,0	-5,8	-2,1	1,8	4,7	4,9	4,4	3,2	1,6	-0,1
EVA, mn USD	7 303	2 356	(3 705)	(1 490)	1 411	4 085	4 885	4 904	4 034	2 243	(105)

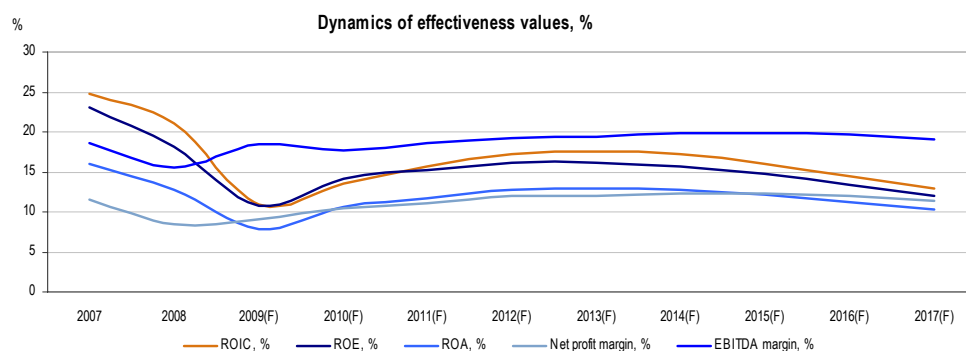
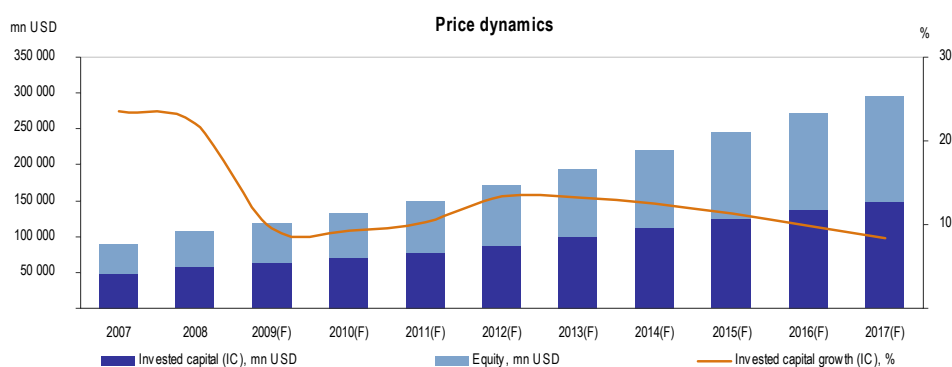
### Business efficiency analysis

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
ROIC, %	24,7	21,1	10,9	13,5	15,7	17,2	17,6	17,2	16,1	14,5	12,9
ROE, %	23,1	18,2	10,8	14,2	15,3	16,2	16,1	15,6	14,7	13,4	12,1
ROA, %	15,9	12,8	7,9	10,6	11,8	12,7	12,9	12,7	12,2	11,3	10,2
EBITDA margin, %	18,6	15,5	18,4	17,7	18,6	19,2	19,3	19,8	19,8	19,7	19,1
EBIT margin, %	16,0	12,7	12,4	12,8	14,1	14,9	15,2	15,6	15,4	15,1	14,3
Net profit margin, %	11,6	8,5	9,1	10,4	11,1	12,0	12,0	12,3	12,2	11,9	11,4

### Financial state analysis

	2007	2008	2009(F)	2010(F)	2011(F)	2012(F)	2013(F)	2014(F)	2015(F)	2016(F)	2017(F)
Financial leverage	0,17	0,19	0,18	0,13	0,09	0,06	0,05	0,03	0,02	0,02	0,01
Financial leverage effect	1,03	1,03	1,09	1,07	1,04	1,03	1,02	1,02	1,01	1,01	1,01
<b>financial leverage characteristics</b>											
Interest-bearing debt / EBITDA	0,46	0,59	0,84	0,54	0,34	0,24	0,18	0,13	0,10	0,07	0,04
Net interest-bearing debt / EBITDA	0,41	0,45	0,73	0,44	0,23	0,14	0,08	0,03	0,00	0,00	0,00
Interest-bearing ST debt / EAT	0,23	0,35	0,49	0,22	0,12	0,06	0,04	0,02	0,01	0,01	0,01
Interest-bearing debt / sales	0,09	0,09	0,15	0,10	0,06	0,05	0,03	0,03	0,02	0,01	0,01
Interest-bearing debt / assets	0,12	0,14	0,13	0,10	0,07	0,05	0,04	0,03	0,02	0,01	0,01
Interest-bearing ST debt / Interest-bearing LT debt	0,46	0,49	0,41	0,31	0,27	0,20	0,15	0,12	0,10	0,09	0,09
EBITDA / Interest payments	46	43	17	21	31	48	64	84	111	147	201
Net debt, mn USD	6 202	7 570	8 666	6 633	4 228	3 120	2 064	952	6	(827)	(1 645)
<b>company's liquidity</b>											
current ratio (>2)	0,86	0,74	0,95	1,18	1,41	1,75	1,99	2,28	2,55	2,85	3,10
quick ratio (>1)	1,84	1,48	1,74	2,07	2,39	2,78	3,06	3,37	3,65	3,97	4,23
absolute liquidity ratio (>0.2)	0,09	0,26	0,31	0,49	0,65	0,95	1,16	1,43	1,68	1,97	2,22
<b>turnover estimates of (days)</b>											
accounts receivable	33	17	33	30	30	30	30	30	30	30	30
inventories	20	12	22	22	22	22	22	22	22	22	22
usage of turnover capital	10,02	21,29	9,39	7,71	6,54	5,41	4,86	4,31	3,91	3,53	3,26

Source: company's data; Estimation: Veles Capital

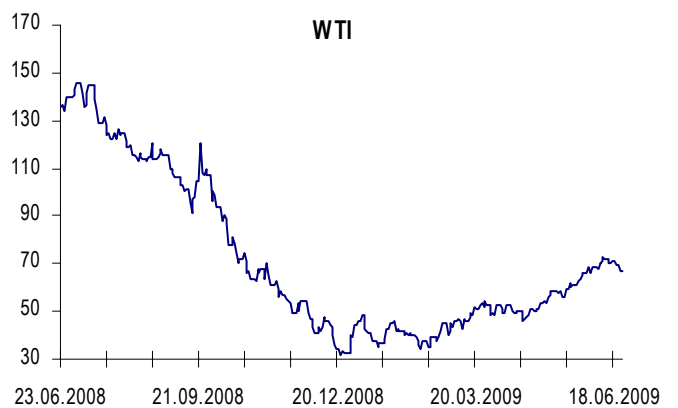
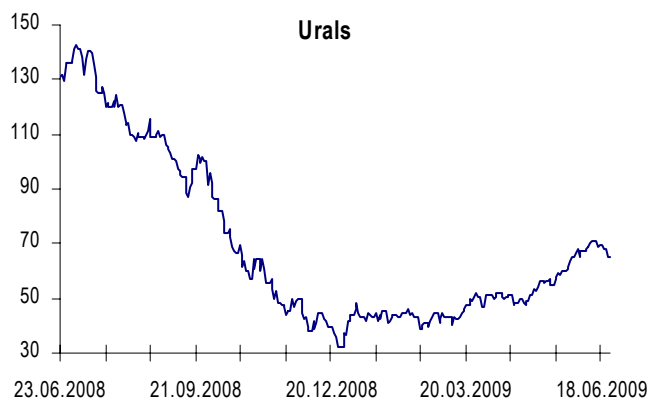
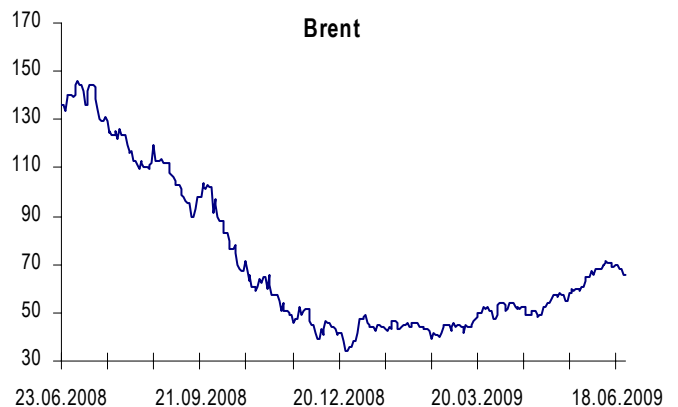
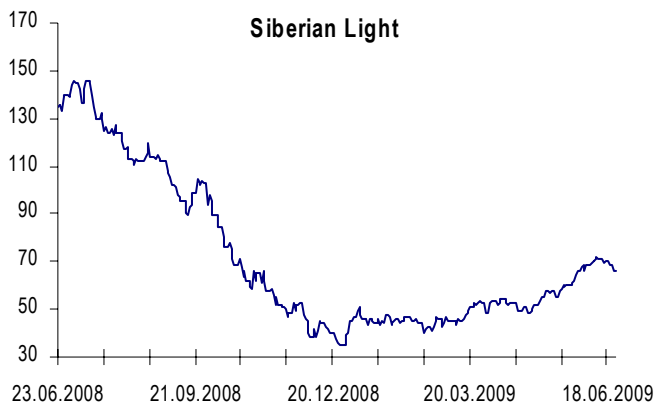


## Commodity markets

### Current oil prices

		Close, USD	Change, USD	Change, %					Current year, USD	
				day	week	month	from Jan 1	year	min	max
Light, USD / bbl	▼	66,11	-2,69	-3,91	-5,23	9,82	46,16	-50,33	39,22	72,18
Brent, USD / bbl	▼	65,72	-2,58	-3,78	-4,93	9,83	57,38	-50,86	35,37	72,05
Urals, USD / bbl	▼	65,26	-2,83	-4,16	-5,43	9,35	56,01	-49,54	35,82	71,10
WTI, USD / bbl	▼	66,93	-2,62	-3,77	-5,23	9,69	50,07	-50,28	33,98	72,73
Brent-Urals	▲	0,46	0,25	119,05	283,33	187,50	-757,14	-89,57	-1,93	5,72

### Oil price graphs



## Brief investor's guide

Methods, used for company's share evaluation					
Income approach			Comparables approach	Expenses approach	
		DCF method	EVA method	Multiplicative method	Net assets method
Concept of evaluating the unified object (EV) *		FCFF discounting	EVA discounting		
Shareholders' value direct calculation (SV) **		FCFE discounting	EVA for shareholders discounting (Edwards-Bell-Ohlson method)		

\*

Debt cost is calculated separately and then subtracted from the sum total cost of business (target EV), formed considering the cash flows/ economic profits of firm.

\*\*

Debt is accounted integrated -via annual coverage. So the fair cost of shareholders' value (target SV) is formed directly - considering the cash flow / economic profits for holders.

Note:

DCF methods differ from the methods of economic profit by the way of investments calculation. The methods of unified object evaluation concept differ from these methods of direct calculation of shareholders' value costs - by the way of accounting cost and maintenance of debt liabilities.

### Cost calculation within the frames of income approach:

	Business cost calculation (EV) within the frames of unified object cost evaluation	Shareholders' capital value calculation (SV)
DCF method (FCFF)	$EV = \sum_{i=1}^n \frac{FCFF_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_1)^n} + NA$	$SV = EV - D$
DCF method (FCFE)		$SV = \sum_{i=1}^n \frac{FCFE_i}{(1+k_{si})^i} + \frac{TV}{(1+k_{si})^n} + Cash + NA$
EVA method	$EV = IC_1 + \sum_{i=1}^n \frac{EVA_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_1)^n} + NA$	$SV = EV - D$
EBO method		$SV = BV_1 + \sum_{i=1}^n \frac{SVA_i}{(1+k_{si})^i} + \frac{TV}{(1+k_{si})^n} + Cash + NA$

### Signs:

EV	- Enterprise Value
SV	- Shareholders Value
TV	- Terminal Value
Cagr	- development rates within the target period
BV, E	- Balance Value, Equity
EBIT	- operational profit from selling, profit before payments of credit interest and income tax
EBITDA	- operational profit before payment of credit interest, income tax and amortization
EBT	- Earnings Before Tax
EAT	- Earnings After Tax
EPS	- Earnings Per Share
NOPAT	- net operational profit, free from effects of debt financing $NOPAT = EBIT * (1 - \text{income tax effective rate})$
FCFF	- Free Cash Flow to Firm $FCFF = \text{gross cash flow} - \text{gross investments}$ $\text{Gross cash flow} = NOPAT + \text{amortization}$
FCFE	- Free Cash Flow to Equity $FCFE = \text{gross shareholders' cash flow} - \text{gross investments}$ $\text{Gross shareholders' cash flow} = \text{EAT of operational profit (including interest payoffs)} - \text{annual debt coverage} + \text{attracted borrowed assets} + \text{amortization}$
EVA	- Economic Value Added $EVA = \text{economic profit spread} * IC = (ROIC - WACC) * IC$
SVA	- Shareholders Value Added $SVA = \text{spread} * E = (ROE - k_s) * E$
WACC	- Weighted Average Cost of Capital
$k_s$	- required shareholders' yield
D	- fair (market) cost of net debt
Cash	- cash assets, along with market securities on thee balance
NA	- non-operational assets
IC	- Invested Capital
ROIC	- Return on Invested Capital $ROIC = \frac{NOPAT}{IC}$
ROE	- Return on Equity
ROA	- Return on Assets

## Information disclosure

### The statement of an analyst and confirmation of the responsibility withdrawal

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### The principle of recommendation assignment

The investment recommendations are given based on the evaluation of the company's share yield. The basis for the calculation of the expected company's cost is the evaluation by the discounted cash flows method (DCF). In some estimations the method of comparable coefficients, and also the mixed estimation (by DCF method and by comparable coefficients method) are applied. All recommendations are assigned based on the determined by us the fair cost of the shares within the nearest 12 months.

At the present moment the investment scale of the Investment Company Veles Capital is the following:

**BUY** – corresponds to the growth potential of the shares within the nearest 12 months by 15% or more.

**ACCUMULATE** – corresponds to the growth potential of the shares within the nearest 12 months for 5-15%.

**HOLD** – corresponds to the growth (reduction) potential of the shares within the nearest 12 months from -5% to 5%.

**REDUCE** – corresponds to the reduction potential of the shares within the nearest 12 months from 15% to 5%.

**SELL** – corresponds to the reduction potential of the shares within the nearest 12 months by 15% or more.

In some cases the deviations from the evaluation scale given above, based on which the recommendations are assigned, are possible. That fact relates to the high volatility of some securities in particular, and market in the whole, and also to the individual characteristics of one or another issuer.

In order to get additional information and specifications please contact the Research Department of the Investment Company Veles Capital.

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