

NOVATEK

Rates regulations continues

Recommendation: BUY

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Bullet moments

- ◆ NOVATEK's IAS-compliant net income of 1Q of 2008 increased by 72.6% in comparison with the same period of 2007 – to 7.503 bn RUR, indicates the company's report and it is higher than our forecasts by 5.3% (7.116 bn RUR).
- ◆ NOVATEK's income rose by +36.8% – to 20.876 bn RUR and appeared to be higher our expectations by 5.4%. Company's oil and gas sales increased by 35.5% – to 20.167 bn RUR, sales of polymer products and insulation tape – by 78.3%, to 0.551 bn RUR.
- ◆ Company's EBITDA increased by 61.8% – to 10.862 bn RUR, EBIT rose by 73.3%, to 9.869 bn RUR. Looking through the financial results of 1Q 2008, it should be mentioned that NOVATEK managed to capitalize its value, increased free cash flow and also kept the leading position of operations efficiency. Thus, EBITDA margin formed 47.3% over the 1Q 2008 (+10 p.p.), net income margin formed 35.9% (+7.4 p.p.).
- ◆ We update NOVATEK's model and put some changes in it. Our changes touched upon oil and gas prices of the company, we increased them by +22.6%. We also reviewed gas sales and raised them by +20.6%, due to government's amendments concerning continuation of domestic gas rates regulation until 2014 and growth of oil prices.
- ◆ It should be mentioned that due to delay of oil companies transfer to equal profitability from 2011 to 2014, the consideration of MET change for NOVATEK can be shifted by 2-3 years, which will have a positive influence on company's securities.
- ◆ We also reviewed the capital investments value and increased it by +20%, due to 1Q data, which appeared to be higher our expectations and total inflation value of oil and gas sector.
- ◆ We reviewed NOVATEK's model and changed it according to the results of 1Q 2008 report and reflected new fair price of the company, which formed 12.05 USD per share and it is by +31.4% higher than forecasted earlier 9.17 USD. The potential growth of company's shares forms 31.7%. We confirm our "BUY" recommendation of company's securities.

Principal estimates

Company's shares vs RTS index



Information about NOVATEK

Ticker RTS	NVTK
Market price (cs), USD	9.15
Min / max price during last year (cs), USD	6,5 / 9,15
Fair price at year end (cs), USD	12.05
Upside (downside) (cs), %	31.69
Number of common shares, total	3,036,306,000
MC, mn USD	27,782
EV, mn USD	30,402

Financial values (IAS)	2007	2008 (F)	2009 (F)
Sales, mn USD	2,443	3,703	4,738
EBITDA, mn USD	1,136	1,903	2,188
Net income, mn USD	733	1,291	1,451
EBITDA margin, %	46.5	51.4	46.2
Net income margin, %	30.0	34.9	30.6

Financial coefficients	2007	2008 (F)	2009 (F)
P/E	37.9	21.5	19.1
P/S	11.37	7.50	5.86
EV/EBITDA	26.8	16.0	13.9

NOVATEK's results of 2007

NOVATEK's IAS-compliant net income of 1Q of 2008 increased by 72.6% in comparison with the same period of 2007 – to 7.503 bn RUR, indicates the company's report and it is higher than our forecasts by 5.3% (7.116 bn RUR).

Company explains the growth of income through a rather positive environment over natural gas and liquid hydrocarbon prices in 1Q 2008, on par with domestic gas prices since January 1st 2008 and rose +25%, while prices of liquid hydrocarbons rose more significantly, adding +70% in 1Q versus 1Q 2007. In addition to this – company continues to show effectiveness in struggle with growth of costs. During first three months of 2008 operating expenses rose by just +15.1% versus similar term of prior year and formed 11,023 bn RUR.

Now, let us get back to financial values: remarkable sales of NOVATEK, which rose +36.8% to a total of 20.876 bn RUR and appeared +5.4% above our estimates. Oil & gas sales expanded by +35.5% to 20.167 bn RUR, sales of polymer products and insulating tape upped +78.3%, to 0.551 bn RUR. Considering a much slower growth of operating costs – this ensured NOVATEK with a high effectiveness of operations. The expansion of operating costs was accompanied by outrunning costs of raw materials up +37.4% and rise of purchased oil and gas by 108%. Other cost items changed just barely or had negative growth dynamics.

Company's EBITDA expanded by 61.8% to 10.862 bn RUR, EBIT upped by 73.3% to 9.869 bn RUR. When looking at financial results of 1Q 2008 we could say that NOVATEK had significantly capitalized its value, adding free cash flow, whilst still holding lead positions on operations effectiveness. EBITDA margin has formed 47.3% in 1Q 2008, appearing 10 p.p. above past year's value, net income margin has formed 35.9%, adding +7.4 p.p. to past year's result.

Production results of company indicate gas extraction of NOVATEK: rising slightly in 1Q and formed 7.578 bn cb m. Even though gas output has been dropped down -24% to 547 bn cb m. Gas sales of 1Q decreased by -8% to 8,391 bn cb m. Such trend of failing gas sales is related to decreased use of gas from underground gas storages of Gazprom. Liquid hydrocarbons extraction rose +7.7% to 631 th tons, sales increased +18.2% to 702 th tons.

In general – we find the results of published report to be positive, both for the company and its stocks, including company's development prospects, the order of development strategy implementation, positive conditions at oil & gas market and prospects of oil sector tax load drop – we think of investments into NOVATEK as adequate and investment appealing.

NOVATEK's IAS financial results of 1Q 2008, mn RUR

	1Q 2007	Chg in 1Q, %	1Q 2008
Sales	15,259	36.8	20,876
<i>Oil and gas sales</i>	14,885	35.5	20,167
<i>Sales of polymer and insulation tape</i>	309	78.3	551
<i>Other revenues</i>	65	143.1	158
Other income (expense)	16	0.0	16
Operational costs	(9,579)	15.1	(11,023)
<i>Transportation expenses</i>	(4,093)	11.3	(4,556)
<i>Taxes other than income tax</i>	(1,609)	9.6	(1,763)
<i>Materials, services and other</i>	(1,069)	37.4	(1,469)
<i>Depreciation, depletion and amortization</i>	(1,018)	-2.5	(993)
<i>General and administrative expenses</i>	(713)	17.4	(837)
<i>Purchases of oil, gas condensate and natural gas</i>	(563)	108.0	(1,171)
<i>Exploration expenses</i>	(202)	13.9	(230)
<i>Net impairment expense</i>	(37)	-83.8	(6)
<i>Changes in inventories</i>	(275)	n/m	2
Operating income	5,696	73.3	9,869
<i>Operating income margin, %</i>	<i>37.3</i>		<i>47.3</i>
EBITDA	6,714	61.8	10,862
<i>EBITDA margin, %</i>	<i>44.0</i>		<i>52.0</i>
Interest receivable	94	-25.5	70
Interest payable	(78)	-26.9	(57)
Foreign exchange gain (loss)	7	1700.0	126
Income (losses) of subsidiaries	0	n/m	(22)
Income before tax	5,719	74.6	9,986
<i>Income before tax margin, %</i>	<i>37.5</i>		<i>47.8</i>
Current income tax	(1,539)	50.3	(2,313)
Deferred income tax	162	n/m	(174)
Net income	4,342	72.7	7,499
<i>Net income margin, %</i>	<i>28.5</i>		<i>35.9</i>
Minority interest	(5)	-20.0	(4)
Shareholder's net yield	4,347	72.6	7,503
<i>Net yield per one common stock</i>	<i>1.43</i>	<i>72.6</i>	<i>2.47</i>

Source: company's data; Estimation: Veles Capital

Forecasts and estimates

We update NOVATEK's model and put some changes in it. The changes concerned oil and gas condensate prices of the company, which were increased by +22.6%, taking into account the current trends of world's economy development and political situation. We reviewed gas prices and increased them by 20.6%. Corrections of gas prices occurred due to government's reconsideration of gas rates policy after 2011, concerning terms shifting of gas companies' transfer to equity profitability of domestic and external market supplies over 2014-2015 period. We took average gas prices of 2007 to our estimations and then made forecasts, on the basis of government's decisions. Thus, on May 6th, 2008 the government made a decision to increase limit level of gas rates in 2008 – by 25%, in 2009 – by 25%, in 2010 – by 30% and in 2011 – by 40%. Growth price dynamics was reviewed for 2011-2013 years. It was intended that to 2011, the domestic gas prices would reach equal profitability with export prices, excluding transport and export tax expenses. However, according to Elvira Nabiulina, the head of Russian Ministry of Economic and Trade, if government applies indirect method of equal profitability, even taking into account forecasted oil prices, added in forecasted trends at 72-80 per bbl of Urals oil, the gas rates should be increased by 95-100% in 2011. It should be also mentioned that in the near future, the government could reconsider long-term forecasts of oil prices and increased them, which will be higher the value of single increase of the prices. However, the compromise decision was accepted. The government kept the equal profitability trend, as it added in many corporate and government agreements, but the transfer will be expended over several years. The country will be fully transferred to equal profitability in 2014-2015. Thus, we reflect in our model our model 25% growth after 2012, 20% after 2013 and 3.1% after 2014, which will allow NOVATEK to transfer to equal profitability of supplies at domestic and external markets, taking into account energy market conditions, which we forecasted. Due to prices overestimation, the fundamental value of the company increased.

Our model now also reflects contributions of final macroeconomic values of Russia during 2007 (GDP, inflation, electric power tariffs and pipeline delivery tariffs) as well as their renewed forecast for the upcoming years. The forecasted results remain unchanged, aside from the results of 2008, which we have upgraded using the expectations of the Russian government and various financial institutions on the growth rates of inflation and GDP.

We must also note that due to the fact that introduction of equal profitability principle is delayed 3 years later, we do not exclude that review of gas extraction tax would also be moved a few years ahead, which is rather positive for NOVATEK. Do remember though, that previous plans indicate that gas extraction tax should be upgraded in 2010. The final financials would have tax load upon the oil industry dropped, oil extraction tax in particular found no such serious reflection, as the oil extraction share within the general extraction structure is remarkably low. Take note that RF's government prepared law bills on cutting the pressure load at oil companies this May, these bills should be approved and enter force starting with January 2009.

Our model now features a reviewed volume of capital investments, increased over the post-forecast period up +20%, due to data of 1Q, which proved to be above our expectations and general growth rate of inflation over the oil & gas industry.

The resulting analysis of NOVATEK and corrections of its model, including results of financials report for 1Q 2008 now indicate a new fair price of the company's stock, which formed 12.05 USD per stock, appearing +31.4% above the previously forecasted price of 9.17 USD. The current potential of NOVATEK's stock forms 31.7%. Therefore we confirm "BUY" recommendation on stocks of the company.

Financial model

Oil and gas extraciton volumes, and refining by NOVATEK, 2006-2016

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Oil extraction (mn t)	2.5	2.5	2.9	3.3	3.8	4.4	5.0	5.8	6.6	7.6	8.8
Gas extraction (bn cb m)	28.6	28.5	31.4	37.6	43.3	47.2	51.0	54.5	58.3	61.9	64.9
Refining (mn t)											
Stable gas refining volume, mn tons	1.6	1.7	1.7	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Liquified hydrocarbonate gas refining volume, mn tons	0.4	0.4	0.4	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Polymer products, th tons	17.3	24.6	27.0	27.6	28.0	28.4	28.8	29.3	29.7	30.2	30.6

Source: company's data; Estimation: Veles Capital

Forecast of oil, gas and oil products sales prices for NOVATEK, 2006-2016

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Sales markets											
Brent oil price, USD/barr	65.1	72.8	108.9	99.8	90.2	95.5	99.3	102.3	105.8	109.2	113.0
Urals oil price, (CIF Mediterranean region), USD/barr	61.4	69.5	104.0	95.3	86.1	91.2	94.8	97.7	101.1	104.3	107.9
Liquid hydrocarbons sales price, USD/t	449.8	509.8	762.3	698.5	631.1	668.5	694.9	716.1	740.7	764.2	790.9
Russian gas price, USD/th cb m, excluding VAT (independent producers)	34.1	43.5	54.3	67.9	86.9	121.7	152.2	182.6	188.2	194.6	200.8
Polymer products price, USD/t	2,359.0	2,550.9	3,394.5	3,579.2	3,664.6	3,833.4	3,939.9	4,020.2	4,013.5	4,022.6	4,012.9

Source: company's data; Estimation: Veles Capital

NOVATEK product sales, 2006-2016, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Oil and gas sales, mn RUR	1,750	2,362	3,589	4,611	5,793	7,998	10,231	12,636	13,960	15,396	16,814
Polymer products and insulating tape sales	41	63	92	99	103	109	114	118	119	121	123
Other sales	8	14	22	28	35	48	61	76	84	92	101
Other gain (loss)	(5)	4	1	1	1	2	3	3	3	4	4
Sales, total	1,794	2,443	3,703	4,738	5,931	8,157	10,408	12,832	14,166	15,613	17,042

Source: company's data; Estimation: Veles Capital

NOVATEK balance sheets, 2006-2016, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Assets											
Operating assets	583	667	725	848	1,261	2,495	4,426	7,118	9,938	12,942	16,001
Reserves	79	70	85	120	158	204	251	303	349	400	453
Cash and equivalents	209	156	181	168	451	1,472	3,190	5,658	8,342	11,199	14,112
Prepayments and other current assets	154	300	252	287	319	374	422	467	487	508	527
Accounts receivable	106	128	194	248	310	427	545	672	741	817	892
Current income tax prepayment	35	13	14	25	22	18	19	20	19	18	18
Non-operating assets	2,525	3,403	4,604	5,502	6,156	6,601	6,993	7,289	7,504	7,651	7,754
Financial investments into subsidiaries	0	44	51	57	60	64	69	74	80	86	91
Debt on long-term loans issued	65	27	24	18	17	15	12	10	8	6	4
PPE	2,460	3,236	4,416	5,312	5,963	6,405	6,793	7,085	7,294	7,436	7,534
Other non-operating assets	0	96	112	116	116	116	118	120	122	124	125
Total assets	3,108	4,069	5,329	6,350	7,417	9,095	11,419	14,408	17,442	20,594	23,756
Liabilities											
Short-term liabilities	188	473	537	478	521	627	740	866	932	992	1,062
Accounts payable and accrued liabilities	66	141	213	273	342	470	600	740	817	900	982
Short-term loaned funds and current share of long-term loans	95	257	244	125	101	82	67	54	45	22	11
Current income tax debt	2	25	27	27	26	25	25	24	24	24	23
Taxes debt, excluding income tax	25	50	53	53	52	50	49	48	47	46	46
Long-term liabilities	389	395	460	485	471	439	402	398	392	386	378
Long-term loans	20	2	41	65	63	44	16	19	19	18	18
Deferred income tax liabilities	310	316	337	338	328	318	311	305	300	296	290
Other long-term liabilities	59	77	82	82	80	77	76	74	73	72	70
Minority interest	13	19	20	20	19	19	18	18	18	17	17
Capital owed to NOVATEK's shareholders	2,518	3,183	4,312	5,367	6,406	8,011	10,258	13,125	16,100	19,198	22,298
Common stocks	14	14	14	14	14	14	14	14	14	14	14
Paid-in capital	1,109	1,109	1,109	1,109	1,109	1,109	1,109	1,109	1,109	1,109	1,109
Income of overestimated new purchases	207	207	207	207	207	207	207	207	207	207	207
Retained earnings	1,188	1,764	2,801	3,849	4,935	6,586	8,864	11,757	14,754	17,872	20,996
Total liabilities	3,108	4,069	5,329	6,350	7,417	9,095	11,419	14,408	17,442	20,594	23,756

Source: company's data; Estimation: Veles Capital

NOVATEK's income and loss statements, 2006-2016, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Revenues	1,794	2,443	3,703	4,738	5,931	8,157	10,408	12,832	14,166	15,613	17,042
Costs and expenses											
Transportation expenses	398	563	767	1,106	1,467	1,840	2,290	2,807	3,352	3,950	4,558
Taxes other than income tax	229	250	337	466	598	805	927	1,059	1,212	1,386	1,591
Materials, services and other	143	193	258	371	489	604	742	896	1,073	1,275	1,485
General and administrative expenses	117	152	207	265	331	456	582	717	792	873	952
Purchases of oil, gas condensate and natural gas	67	127	186	280	399	590	780	982	1,069	1,152	1,230
Exploration expenses	17	19	38	53	69	83	101	119	140	163	186
Net impairment income (expense)	4	6	9	12	15	20	26	31	35	38	42
Changes in inventories	(22)	(1)	(1)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
EBITDA	841	1,136	1,903	2,188	2,564	3,760	4,965	6,222	6,496	6,779	7,000
EBITDA margin, %	46.9	46.5	51.4	46.2	43.2	46.1	47.7	48.5	45.9	43.4	41.1
PPE amortization	135	144	166	237	289	333	368	395	416	432	440
EBIT	706	993	1,737	1,950	2,274	3,427	4,597	5,827	6,080	6,347	6,560
EBIT margin, %	39.3	40.6	46.9	41.2	38.3	42.0	44.2	45.4	42.9	40.7	38.5
Non-operating income/expenses	(1)	5	(15)	(16)	(8)	(3)	6	11	11	12	14
Income before tax	705	998	1,722	1,935	2,267	3,424	4,603	5,838	6,091	6,360	6,574
Income before tax margin, %	39.3	40.8	46.5	40.8	38.2	42.0	44.2	45.5	43.0	40.7	38.6
Income tax	(189)	(286)	(430)	(484)	(567)	(856)	(1,151)	(1,460)	(1,523)	(1,590)	(1,643)
Net income	519	733	1,291	1,451	1,700	2,568	3,453	4,379	4,568	4,770	4,930
Net income margin, %	28.9	30.0	34.9	30.6	28.7	31.5	33.2	34.1	32.2	30.5	28.9

Source: company's data; Estimation: Veles Capital

NOVATEK's cash flows, 2006-2016, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Operating activities											
Income before income tax	705	998	1,722	1,935	2,267	3,424	4,603	5,838	6,091	6,360	6,574
Adjustments to income before income tax											
Depreciation and amortization	137	146	166	237	289	333	368	395	416	432	440
Net impairment expense	4	6	9	12	15	20	26	31	35	38	42
Foreign exchange loss (gain)	(8)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Net loss (gain) on disposal of assets	8	(4)	1	1	1	2	3	3	3	4	4
Share-based compensation	6	7	0	0	0	0	0	0	0	0	0
Interest expense	19	10	23	24	16	14	10	7	6	5	3
Interest income	(10)	(15)	(3)	(3)	(2)	(5)	(10)	(11)	(10)	(10)	(10)
Share of income in associates	0	0	(5)	(5)	(5)	(6)	(6)	(7)	(7)	(7)	(7)
Net change in other non-current assets	(2)	(7)	5	6	0	1	3	2	1	2	2
Other adjustments	(3)	1	(10)	(3)	(4)	(4)	(5)	(4)	(4)	(4)	(4)
Cash flows provided by operating activities, before change of turnover capital	856	1,142	1,908	2,204	2,576	3,779	4,991	6,255	6,532	6,819	7,045
Change of turnover assets	(46)	(162)	(0)	(134)	(150)	(239)	(235)	(248)	(160)	(171)	(177)
Change of turnover liabilities	14	96	64	59	77	139	140	151	89	95	99
Total effect of working capital changes	(32)	(66)	63	(75)	(73)	(100)	(95)	(97)	(71)	(75)	(79)
Income taxes paid	(212)	(239)	(430)	(484)	(567)	(856)	(1,151)	(1,460)	(1,523)	(1,590)	(1,643)
Net cash provided by operating activities	612	837	1,540	1,645	1,936	2,823	3,745	4,699	4,939	5,154	5,322
Cash flows from investing activities											
Purchases of property, plant and equipment	(174)	(812)	(1,148)	(1,128)	(1,117)	(985)	(919)	(850)	(782)	(722)	(718)
Net cash (used for) provided by investing activities	(174)	(812)	(1,148)	(1,128)	(1,117)	(985)	(919)	(850)	(782)	(722)	(718)
Cash flows from financing activities											
Proceeds from long-term borrowings	138	213	62	43	61	49	40	33	27	22	11
Proceeds from short-term borrowings	(164)	(34)	(91)	(163)	(81)	(65)	(53)	(44)	(36)	(44)	(22)
Repayments of long-term borrowings	99	0	41	65	0	2	3	3	2	1	1
Repayments of short-term borrowings	(274)	(90)	(2)	(41)	0	(19)	(30)	(0)	(1)	(1)	(1)
Interest paid	(11)	(4)	0	0	0	0	0	0	0	0	0
Dividends paid	(121)	(229)	(387)	(435)	(510)	(770)	(1,036)	(1,314)	(1,371)	(1,431)	(1,479)
Net cash (used for) provided by financing activities	(333)	(144)	(378)	(531)	(530)	(804)	(1,076)	(1,322)	(1,378)	(1,454)	(1,490)
Net effect of exchange rate changes on cash, cash equivalents	(5)	(0)	0	0	0	0	0	0	0	0	0
Net decrease of mandatory reserves in Bank of Russia	0	0	0	0	0	0	0	0	0	0	0
Net increase (decrease) in cash, cash equivalents	100	(120)	15	(14)	289	1,034	1,750	2,528	2,778	2,979	3,114
Cash and cash equivalents at the beginning of the reporting period	109	222	166	181	163	437	1,440	3,130	5,563	8,220	10,998
Cash, cash equivalents at the end of the reporting period	209	102	181	168	451	1,472	3,190	5,658	8,342	11,199	14,112

Source: company's data; Estimation: Veles Capital

Financial analysis

Value forming estimates

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Growth of invested capital (IC), %	8.3	35.6	26.1	21.4	17.6	16.9	16.7	16.7	16.7	16.6	15.6
Invested capital (IC), %	2,437.0	3,304.6	4,167.2	5,059.7	5,922.3	6,921.4	8,074.3	9,424.0	10,997.2	12,820.7	14,818.3
Equity, mn USD	2,518.2	3,183.4	4,050.6	5,020.1	6,180.7	7,979.8	10,439.1	13,613.5	16,982.3	20,550.8	24,305.4

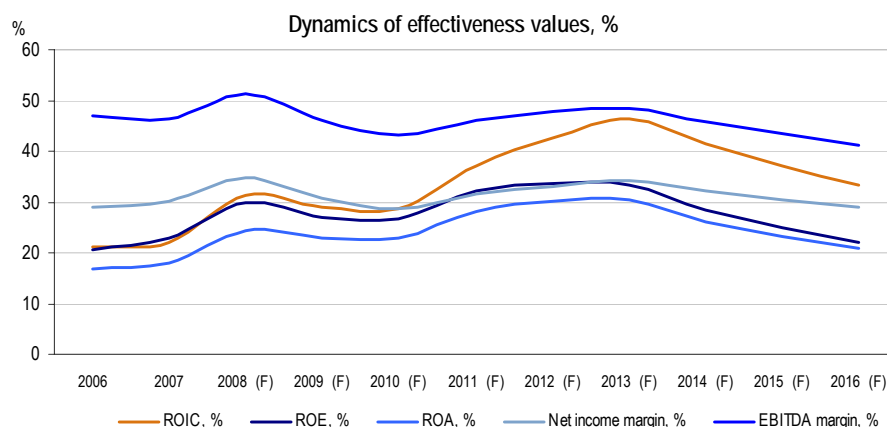
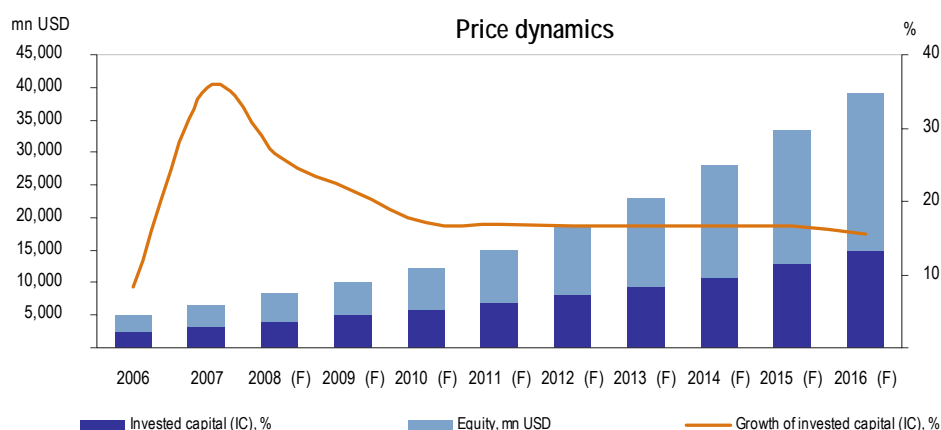
Business effectiveness analysis

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
ROIC, %	21.2	22.1	31.3	28.9	28.8	37.1	42.7	46.4	41.5	37.1	33.2
ROE, %	20.6	23.0	29.9	27.0	26.5	32.1	33.7	33.4	28.4	24.8	22.1
ROA, %	16.7	18.0	24.2	22.8	22.9	28.2	30.2	30.4	26.2	23.2	20.8
EBITDA margin, %	46.9	46.5	51.4	46.2	43.2	46.1	47.7	48.5	45.9	43.4	41.1
EBIT margin, %	39.3	40.6	46.9	41.2	38.3	42.0	44.2	45.4	42.9	40.7	38.5
Net income margin, %	28.9	30.0	34.9	30.6	28.7	31.5	33.2	34.1	32.2	30.5	28.9

Financial state analysis

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Financial leverage	0.05	0.08	0.07	0.04	0.03	0.02	0.01	0.01	0.00	0.00	0.00
liquidity estimates											
coverage ratio	1.68	0.60	0.70	0.87	1.46	3.03	5.05	7.31	9.74	12.11	14.13
current ratio	3.10	1.41	1.35	1.77	2.42	3.98	5.98	8.22	10.66	13.05	15.07
quick ratio	1.11	0.33	0.34	0.35	0.87	2.35	4.31	6.53	8.95	11.29	13.29
business activity estimates											
accounts receivable coverage period, days	21	19	19	19	19	19	19	19	19	19	19
turnover of supplies, days	16	10	8	9	10	9	9	8	9	9	10
use of own turnover capital	0.77	0.83	0.91	0.94	1.05	1.37	1.66	2.00	2.16	2.34	2.55

Source: company's data; Estimation: Veles Capital



Fair price estimation

	Discount rate (WACC), %										
	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Cost of equity (ks)	11.86	11.86	11.83	11.83	11.83	11.83	11.83	11.83	11.83	11.83	11.83
Risk-free rate, %	5.84	5.84	5.80	5.80	5.80	5.80	5.80	5.80	5.80	5.80	5.80
10 year US Treasuries yield, %	4.73	4.73	4.38	4.15	4.15	4.15	4.15	4.15	4.15	4.15	4.15
Russia risk, %	1.11	1.11	1.42	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65
Stock market risk, %	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
B Coefficient	0.93	0.93	0.93	0.93	0.93	0.93	0.93	0.93	0.93	0.93	0.93
Share of equity, %	95.6	92.5	93.8	96.6	97.5	98.5	99.2	99.4	99.6	99.8	99.9
Cost of debt (kd)	7.56	10.50	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
Risk-free rate, %	5.84	5.84	5.80	5.80	5.80	5.80	5.80	5.80	5.80	5.80	5.80
Cost of debt, %	1.73	4.67	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
Tax rate, %	26.75	26.53	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00
Share of debt, %	4.35	7.51	6.20	3.42	2.50	1.54	0.80	0.55	0.40	0.21	0.13
WACC	11.59	11.55	11.46	11.63	11.68	11.74	11.78	11.79	11.80	11.81	11.82

Source: company's data, Estimation: Veles Capital

Free Cash Flows of NOVATEK, 2006-2016, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
EBITDA	841	1,136	1,903	2,188	2,564	3,760	4,965	6,222	6,496	6,779	7,000
Amortization and depreciation	135	144	166	237	289	333	368	395	416	432	440
EBIT	706	993	1,737	1,950	2,274	3,427	4,597	5,827	6,080	6,347	6,560
Income tax	(204)	(286)	(430)	(484)	(567)	(856)	(1,151)	(1,460)	(1,523)	(1,590)	(1,643)
after-tax EBIT	638	851	1,472	1,704	1,997	2,904	3,814	4,763	4,974	5,189	5,357
CapEx	(164)	(745)	(1,148)	(1,128)	(1,117)	(985)	(919)	(850)	(782)	(722)	(718)
Change of operating capital	(32)	(66)	63	(75)	(73)	(100)	(95)	(97)	(71)	(75)	(79)
FCF	835	61	384	498	805	1,819	2,801	3,819	4,124	4,395	4,563

Source: company's data, Estimation: Veles Capital

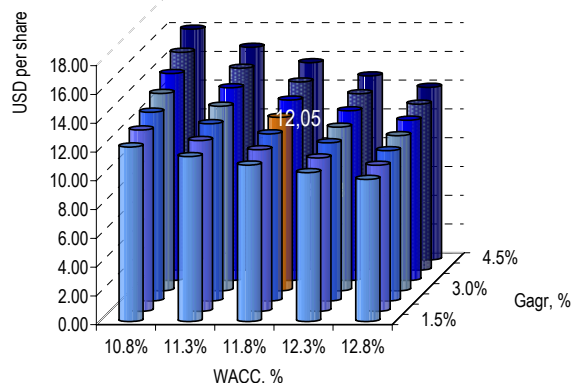
NOVATEK's stocks valuation

TGR, %	3.00
Terminal value, mn USD	58,101
Discounted terminal value, mn USD	21,261
Enterprise value, mn USD	34,469
Net debt, mn USD	103
Shareholder's equity (incl. minority interest), mn USD	34,367
Number of shares, mn units	3,036,306,000
Fair value of common stock at the year end, USD	12.05
Upside (downside) of common stock, %	31.69

Source: company's data, Estimation: Veles Capital

Analysis of the share's weighted average fair value sensitivity

Growth rate in postforecasted period, %	WACC, %				
	10.8%	11.3%	11.8%	12.3%	12.8%
1.5%	12.13	11.46	10.87	10.35	9.88
2.0%	12.60	11.87	11.23	10.66	10.15
2.5%	13.12	12.32	11.62	11.00	10.45
3.0%	13.71	12.82	12.05	11.37	10.77
3.5%	14.38	13.39	12.54	11.79	11.14
4.0%	15.15	14.04	13.08	12.26	11.54
4.5%	16.04	14.78	13.71	12.79	12.00



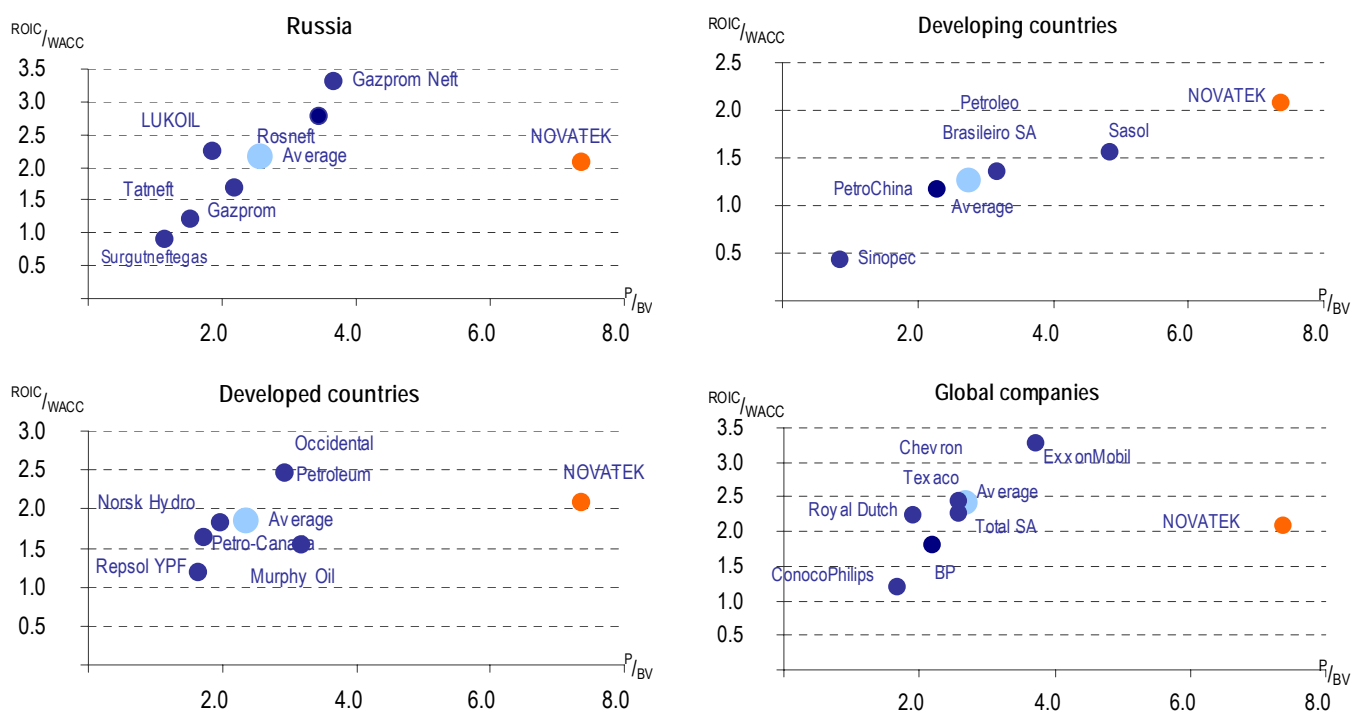
Source: estimation of Veles Capital

Comparable analysis

Company	Country	Ticker	Current capitalization, mn USD	Market multipliers				Financial multipliers				
				P/S	P/E	EV/EBITDA	P/BV	ROE, %	ROA, %	ROIC, %	WACC, %	ROIC _{WACC}
Gazprom	Russia	GAZP RU	341,372	3.54	13.20	9.91	2.18	21.28	12.70	16.51	9.84	1.68
LUKOIL	Russia	LKOH RU	82,675	1.07	7.07	4.99	1.86	25.67	17.63	22.46	10.05	2.23
Gazprom Neft	Russia	SIBN RU	37,930	1.97	10.17	-	3.68	40.69	26.98	33.44	10.15	3.29
Surgutneftegas	Russia	SNGS RU	44,846	1.81	11.92	-	1.14	9.83	9.15	9.71	10.84	0.90
Tatneft	Russia	TATN RU	16,906	1.16	12.85	6.85	1.54	13.84	9.90	13.59	11.30	1.20
TNK-BP	Russia	TNBP RU	34,863	1.49	5.15	-	2.88	73.96	31.86	60.87	10.70	5.69
Transneft	Russia	TRNFP RU	8,521	0.70	3.22	3.35	0.37	15.09	10.38	13.94	11.06	1.26
Rosneft	Russia	ROSN RU	118,488	1.88	14.78	8.24	3.46	51.13	21.16	29.45	10.64	2.77
NOVATEK	Russia	NVTK RU	27,782	7.50	21.52	15.98	7.37	25.04	19.90	23.62	11.38	2.08
Russia average				2.75	12.31	9.00	2.57	29.53	16.34	22.17	10.23	2.16
PetroChina	China	857 HK	399,930	1.98	11.34	10.44	2.29	22.06	15.07	20.44	17.45	1.17
Petroleo Brasileiro SA	Brazil	PETRA BZ	269,120	2.15	15.80	9.27	3.18	20.35	9.74	16.07	11.87	1.35
Sasol	SAR	SOL SJ	38,706	2.45	16.81	-	4.85	29.82	15.33	23.82	15.31	1.56
Sinopec	China	338 HK	5,880	0.33	11.04	18.51	0.87	8.25	5.71	7.45	17.36	0.43
Emerging markets average				2.06	13.32	10.04	2.75	21.72	13.00	18.87	15.23	1.25
Murphy Oil	USA	MUR US	17,421	0.80	16.17	7.96	3.20	16.69	8.51	13.46	8.73	1.54
Norsk Hydro	Norway	NHY NO	18,652	0.72	7.04	-	1.74	24.17	11.16	21.40	13.18	1.62
Occidental Petroleum	USA	OXY US	70,632	3.44	13.16	5.97	2.95	25.67	15.66	24.14	9.86	2.45
Petro-Canada	Canada	PCA CN	26,521	1.15	9.67	3.52	1.97	24.50	11.76	19.69	10.81	1.82
Repsol YPF	Spain	REP SM	47,807	0.56	8.83	-	1.64	17.74	6.90	11.95	10.03	1.19
Developed markets average				1.81	11.16	5.71	2.36	22.39	11.62	18.96	10.28	1.85
BP	UK	BP/ LN	216,116	0.71	9.19	5.72	2.20	23.39	9.19	18.64	10.41	1.79
Chevron Texaco	USA	CVX	204,026	0.93	10.82	5.43	2.60	25.60	13.28	23.11	9.47	2.44
ConocoPhillips	USA	COP	146,039	0.86	9.01	5.95	1.68	13.86	6.94	11.33	9.58	1.18
ExxonMobil	USA	XOM US	459,259	1.22	11.30	5.74	3.73	34.47	17.61	32.47	9.96	3.26
Royal Dutch	Holland	RDSA LN	246,438	0.62	7.47	4.38	1.91	27.28	12.41	23.75	10.70	2.22
Total SA	France	FP FP	197,271	0.82	8.64	4.25	2.58	30.95	12.05	22.81	10.16	2.25
Global average				0.91	9.70	5.29	2.68	27.88	13.09	24.27	10.07	2.41

Source: Bloomberg, Estimation: Veles Capital

Effectiveness and assessment ratio of Rosneft's assets versus other companies



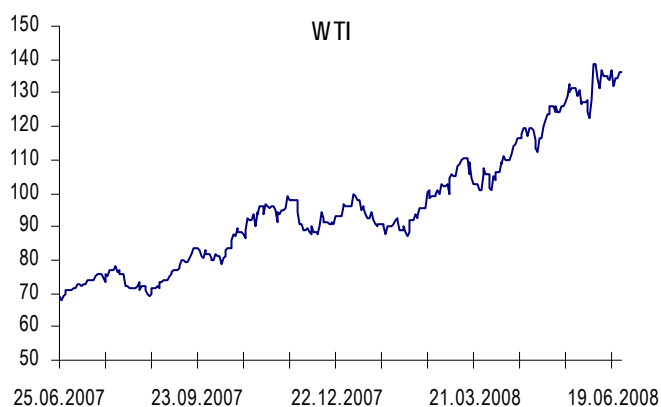
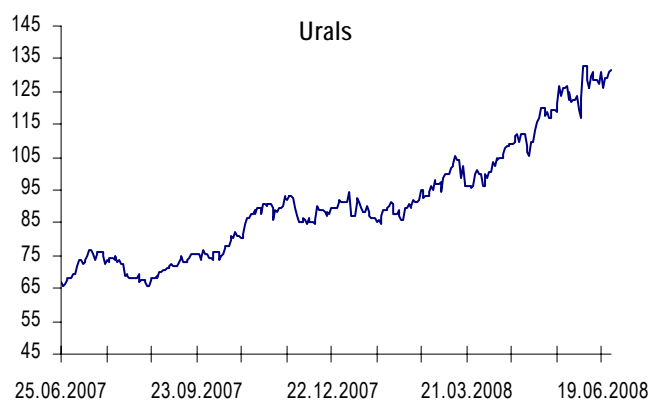
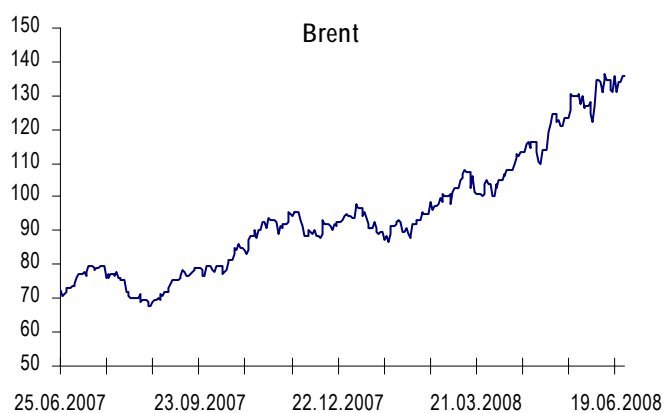
Source: Bloomberg; Estimation: Veles Capital

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	▲	135,35	0,69	0,51	3,17	2,86	41,14	92,31	86,75	136,83
Brent, USD / bbl	▲	136,00	0,21	0,15	3,75	4,49	44,85	88,16	85,05	138,34
Urals, USD / bbl	▲	131,76	0,69	0,53	3,45	4,66	44,35	97,30	82,80	132,88
WTI, USD / bbl	▲	136,40	0,40	0,29	1,78	3,66	42,08	97,88	86,47	138,88
Brent-Urals	▼	4,24	-0,48	-10,17	13,67	-0,47	62,45	-22,91	1,66	9,94

Oil prices charts



Brief investor's guide

Methods, used for company's share evaluation				
Income approach			Comparables approach	Expenses approach
			Multiplicative method	Net assets method
	DCF method	EVA 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 - income tax effective rate)
FCFF	- Free Cash Flow to Firm FCFF = gross cash flow - gross investments Gross cash flow = NOPAT + amortization
FCFE	- Free Cash Flow to Equity FCFE = gross shareholders' cash flow - gross investments Gross shareholders' cash flow = EAT of operational profit (including interest payoffs) - annual debt coverage + attracted borrowed assets + amortization
EVA	- Economic Value Added EVA = economic profit spread * IC = (ROIC - WACC) * IC
SVA	- Shareholders Value Added SVA = 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 = 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.

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