

NOVATEK

Market rejects positive results

Recommendation: BUY

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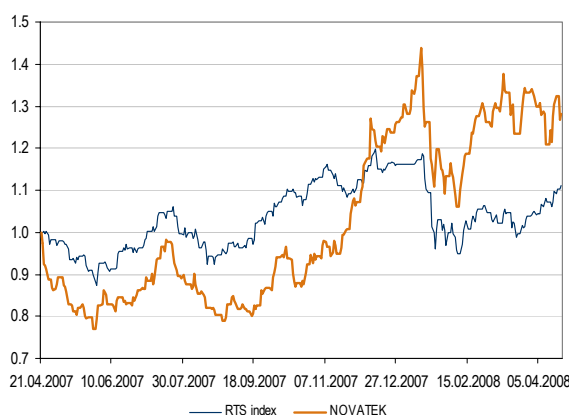
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Bullet moments

- ◆ NOVATEK's net income by IAS 2007 rose +33.1% versus 2006 to 18.736 bn RUR – announced company's report. Although results exceeded our forecast by +8.5% (17.254 bn RUR), as market's general forecast formed 19.325 bn RUR.
- ◆ Sales of the company expanded +26.2% to 62.32 bn RUR and appeared +3.8% over our estimates. EBITDA grew +27.2% to 29.033 bn RUR, EBIT added +32.4% to a total of 25.365 bn RUR.
- ◆ The growth of financial values of 2007 become possible due to a more than simply positive price environment for natural gas and liquid hydrocarbons in whole 2007 and 4Q 2007 in particular. More to that throughout all of 2007 company was successful at keeping costs at a decent level, making them grow below sales growth rate.
- ◆ Thanks to costs management and a significant growth of sales, company's effectiveness had also been expanded in 2007. EBITDA margin has formed 46.6% in 2007, appearing above past result up +0.4 p.p., net income margin has formed 30.1%, which is 1.7 p.p. over previous value.
- ◆ In general we estimate issued reports as positive for company and its shares, even considering the fact that company did not met market's overrated expectations on results of 2007.
- ◆ We have corrected NOVATEK's model, adding several changes to it. In particular we have changed capital investments of the company upwards, on par with production plans of NOVATEK and macroeconomic parameters.
- ◆ We have also revaluated NOVATEK's model, adding results of financial report of 2007 and issued a new fair price of the company, which formed 9.17 USD per share, which is 9% above previously forecasted price of 8.41 USD. We see current potential for growth of NOVATEK's shares forms 20%. Due to this we confirm "BUY" recommendation on company's stock.

Principal estimates

Company's shares vs RTS index



Information about NOVATEK

Ticker RTS	NVTK
Market price (cs), USD	7.72
Min / max price during last year (cs), USD	6,50 / 8,70
Fair price at year end (cs), USD	9.17
Upside (downside) (cs), %	18.77
Number of common shares, total	3,036,306,000
MC, mn USD	23,440
EV, mn USD	26,060

Financial values (IAS)	2007	2008 (F)	2009 (F)
Sales, mn USD	2,440	3,403	4,316
EBITDA, mn USD	1,133	1,531	1,912
Net income, mn USD	733	992	1,205
EBITDA margin, %	46.4	45.0	44.3
Net income margin, %	30.1	29.1	27.9

Financial coefficients	2007	2008 (F)	2009 (F)
P/E	32.0	23.6	19.5
P/S	9.61	6.89	5.43
EV/EBITDA	23.0	17.0	13.6

NOVATEK results of 2007

NOVATEK's net income of IAS 2007 upped +33.1% versus 2006, to a total of 18.736 bn RUR, says company's report. This value appeared +8.5% on top of our forecasts (17.254 bn RUR). If we compare net income with the general forecast, then we would see a totally different situation, whereas many players have expected a significant increase of this value and targeted annual value of 19.325 bn RUR.

Company explains such growth of income through very positive conditions over prices of natural gas and liquid hydrocarbons in 2007, during 4Q in particular, on par with expanded sales volumes of liquid hydrocarbons within sales structure of NOVATEK. More to that, company held its costs at bay throughout whole year, pushing them below sales growth rate.

Now, let us get back to financials of the company, sales in particular, which rose +26.2% to 62.32 bn RUR and proved +3.8% over our forecasts. The sales of oil and gas rose +25.6% to 60.357 bn RUR, sales of polymer products and insulating tape added almost +45%, to 1.602 bn RUR. Operating costs of 2007 have also expanded, though they rose below sales, adding just +23.2% and forming a total of 37.066 bn RUR. The growth of operating costs was accompanied mostly by outrunning expansion of transport costs (+26.5 – which brings fears around market players), raw goods and materials +26.5% and growth of purchased oil & gas price +79.6%. Other expenditures rose at a much slower paces or even dropped down.

Company's EBITDA increased +27.2% to 29.033 bn RUR, EBIT added +32.4% to 25.365 bn RUR. When examining financial results of the company during 2007 we could say that NOVATEK was able to capitalize its value, adding a free cash flow, also entering the leading positions on operations effectiveness. EBITDA margin of 2007 has formed 46.6%, adding +0.4 p.p. to previous value, net income margin has formed 30.1%, adding above previous value over +1.7 p.p.

In general – we find this news to be much more than simply positive for the company and its shares, even considering the fact that company failed to meet market's expectations. We think that results of first quarter would bring back investors view of company's stock. We would first like to note that under growth trends of oil & gas industry's average costs of extraction and development, NOVATEK still succeeded at sustaining a controlled rate of costs, stopping sudden and unpredicted hikes. We think that under current conditions of commodity markets NOVATEK would further show such brilliant results, and these results would then reflect upon company's quotes and paid dividends. Speaking of latter, we must note that not so long ago the board of company recommended shareholders to approve dividends of 2007 at 2.35 RUR per share (including payoffs of 1H), which forms 38% of company's net income. Last year's dividends have formed 1.65 RUR per share and formed a total of 35% of net income. We must underline that company's IPO set dividends at 30% of net income. Which is a sound aspect in our opinion, as company does not store cash at accounts, waiting for some events in the future, instead approaching the issue pragmatically, through estimating its growth potential, possibilities and current strength, thus if they have enough liquidity, why would not they pay higher dividends.

NOVATEK IAS 2007 financials, mn RUR

	4Q 2006	Chg during 4Q, %	4Q 2007	2006	Chg during year, %	2007
Sales	11,876	41.8	16,836	49,373	26.2	62,321
<i>Oil and gas sales</i>	11,544	40.9	16,264	48,047	25.6	60,357
<i>Sales of polymer and insulation tape</i>	285	64.6	469	1,109	44.5	1,602
<i>Other revenues</i>	47	119.1	103	217	66.8	362
Associates income (expense)	9	755.6	77	9	955.6	95
Other income (expense)	95	n/m	(9)	(148)	n/m	15
Operational costs	(7,745)	28.8	(9,975)	(30,081)	23.2	(37,066)
<i>Transportation expenses</i>	(3,078)	11.4	(3,429)	(11,362)	26.5	(14,372)
<i>Taxes other than income tax</i>	(1,575)	9.8	(1,730)	(6,223)	2.5	(6,379)
<i>Materials, services and other</i>	(999)	54.4	(1,542)	(3,893)	26.5	(4,924)
<i>Depreciation, depletion and amortization</i>	(631)	28.1	(808)	(3,671)	-0.1	(3,668)
<i>General and administrative expenses</i>	(848)	34.2	(1,138)	(3,165)	22.4	(3,873)
<i>Purchases of oil, gas condensate and natural gas</i>	(639)	148.0	(1,585)	(1,805)	79.6	(3,242)
<i>Exploration expenses</i>	(52)	-44.2	(29)	(459)	5.9	(486)
<i>Net impairment expense</i>	(27)	85.2	(50)	(100)	53.0	(153)
<i>Changes in inventories</i>	104	223.1	336	597	-94.8	31
Operating income	4,235	63.6	6,929	19,153	32.4	25,365
<i>Operating income margin, %</i>	35.7		41.2	38.8		40.7
EBITDA	4,866	59.0	7,737	22,824	27.2	29,033
<i>EBITDA margin, %</i>	41.0		46.0	46.2		46.6
Interest receivable	78	21.8	95	274	37.2	376
Interest payable	(125)	-54.4	(57)	(516)	-49.0	(263)
Foreign exchange gain (loss)	14	185.7	40	211	-94.8	11
Income before tax	4,202	66.8	7,007	19,122	33.3	25,489
<i>Income before tax margin, %</i>	35.4		41.6	38.7		40.9
Current income tax	(914)	148.6	(2,272)	(5,527)	32.1	(7,301)
Deferred income tax	(511)	n/m	323	412	31.1	540
Net income	2,777	82.1	5,058	14,007	33.7	18,728
<i>Net income margin, %</i>	23.4		30.0	28.4		30.1
Minority interest	0	n/m	4	(72)	-88.9	(8)
Shareholder's net yield	2,777	82.0	5,054	14,079	33.1	18,736
<i>Net yield per one common stock</i>	0.91	82.0	1.66	4.64	33.0	6.17

Source: company's data; Estimation: Veles Capital

Forecasts and estimates

We have corrected our model of NOVATEK, introducing several changes to it. In particular – we have modified our forecast of oil prices and prices of condensed gas upwards at average of 10%, using current trends and forecast of future development of world economy and world's political environment.

Our model also reflects contributions of final macroeconomic values of Russia (GDP, inflation, electric energy tariffs, pipeline transportation and railroad transportation) of past year and forecast for the upcoming year.

We have also introduced changes into forecast of prices on natural gas after 2011, taking into account latter discussions about inability to make such a sharp transition to equal profitability of export and domestic gas shipments, which was forecasted earlier. As in this case, gas prices would double in 2011 under current environment at world energy carriers market, which on its part cause damage upon Russian industry. According to the latest offers by MEDT, which were obviously supported by the government, we point out idea on stretching application of equal profitability principle for several years. MEDT offered to continue annual indexation of gas prices for domestic consumers, and in 2011 gas price is intended to add +33%. If these decisions are made, then the revaluation of tariffs is likely to be delayed, which is positive for NOVATEK.

Our model now also holds revaluated volume of capital investments, which was increased at average of 10% in post-forecast term, as we assume that in order to meet such ambitious development plans, company may prove to have insufficient funds, at base of which NOVATEK build its plans. We relate this to the fact that costs of preparation and development of deposits rises each year rather fast, and under limited offer of service, we are not speaking about slowing here either.

A positive aspect for NOVATEK's development is the upcoming liberalization of Russia's market, which would bring company's financials at a whole new, quality level. At the end of 1Q we would be able to estimate the intended growth of current value, just off expanded domestic tariffs +25%, not to mention increased operations volumes. In general, we think that NOVATEK would be able to further hold costs at bay, in accordance with company's sales growth rate.

The sole thing important is investors' attention to overestimation of stocks of the company under a range of values of comparable estimation, which is menacing.

The resulting analysis of NOVATEK and model corrections, including financial report of 2007, brought us a new fair price which forms 9.17 USD per share or +9% above previously forecasted price of 8.41 USD. Current potential of NOVATEK forms 20%, therefore we confirm "BUY" recommendation on company's stock.

Financial model

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

	2006	2,007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Oil extraction (mn tons)	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	31.9	35.8	40.1	43.7	47.2	50.5	54.0	57.2	60.7
Refining (mn tons)											
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	18.2	18.6	18.9	19.2	19.5	19.8	20.1	20.4	20.7	21.0

Source: company's data; Estimation: Veles Capital

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

	2006	2,007	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	89.0	81.1	72.2	77.3	80.5	83.5	86.7	85.4	84.6
Urals oil price, (CIF Mediterranean region), USD/barr	61.4	69.5	85.0	77.4	68.9	73.8	76.9	79.7	82.8	81.5	80.8
Liquid hydrocarbons sales price, USD/t	449.8	509.8	623.1	567.3	505.0	541.0	563.7	584.2	606.6	597.4	591.9
Russian gas price, USD/th cb m, excluding VAT (independent producers)	34.1	43.5	54.3	69.4	88.6	117.9	125.5	133.7	141.0	148.8	156.2
Polymer products price, USD/t	2,359.0	3,446.2	4,585.9	5,880.7	7,281.2	9,379.6	9,778.0	10,217.1	10,599.0	11,018.4	11,361.6

Source: company's data; Estimation: Veles Capital

NOVATEK product sales, 2006-2016, mn USD

	2006	2,007	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	3,298	4,178	5,194	6,973	7,936	8,981	10,128	11,201	12,327
Polymer products and insulating tape sales	41	63	85	111	140	183	194	205	216	228	239
Other sales	8	14	20	25	31	42	48	54	61	67	74
Other gain (loss)	(5)	1	1	1	1	2	2	2	3	3	3
Sales, total	1,794	2,440	3,403	4,316	5,366	7,200	8,179	9,243	10,407	11,499	12,643

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	659	935	1,084	1,530	2,532	3,989	5,738	7,721	9,878	12,131
Reserves	79	69	97	127	157	194	224	257	295	334	376
Cash and equivalents	209	154	223	173	406	1,053	2,306	3,836	5,578	7,505	9,516
Prepayments and other current assets	154	296	411	530	659	885	1,005	1,136	1,279	1,413	1,554
Accounts receivable	106	126	175	226	281	377	429	484	545	603	663
Current income tax prepayment	35	13	28	28	27	23	25	24	23	23	23
Non-operating assets	2,525	3,364	4,360	5,188	5,723	5,979	6,201	6,359	6,455	6,498	6,511
Financial investments into subsidiaries	0	44	50	56	60	63	68	72	77	82	87
Debt on long-term loans issued	65	26	23	18	17	15	12	10	8	6	4
PPE	2,460	3,199	4,185	5,010	5,545	5,801	6,024	6,181	6,275	6,316	6,328
Other non-operating assets	0	95	101	104	102	99	97	96	95	94	92
Total assets	3,108	4,024	5,295	6,272	7,253	8,511	10,189	12,097	14,176	16,376	18,643
Liabilities											
Short-term liabilities	188	467	515	439	476	563	604	654	711	753	808
Accounts payable and accrued liabilities	66	139	193	249	310	416	472	534	601	664	730
Short-term loaned funds and current share of long-term loans	95	254	243	110	89	72	59	48	39	19	9
Current income tax debt	2	25	26	27	26	25	25	24	24	24	23
Taxes debt, excluding income tax	25	49	52	53	52	50	49	48	47	46	46
Long-term liabilities	389	390	720	790	766	463	420	428	410	390	369
Long-term loans	20	2	308	369	358	68	33	49	38	22	8
Deferred income tax liabilities	310	313	331	338	328	318	311	305	300	296	290
Other long-term liabilities	59	76	80	82	80	77	76	74	73	72	70
Minority interest	13	18	20	20	19	19	18	18	18	17	17
Capital owed to NOVATEK's shareholders	2,518	3,148	4,041	5,023	5,991	7,467	9,147	10,997	13,036	15,216	17,448
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	1,744	2,554	3,506	4,520	6,042	7,752	9,628	11,691	13,890	16,146
Total liabilities	3,108	4,024	5,295	6,272	7,253	8,511	10,189	12,097	14,176	16,376	18,643

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											
Profit before income tax	705	986	1,327	1,640	2,088	3,155	3,559	3,929	4,315	4,604	4,875
Adjustments to profit before income tax											
Depreciation and amortization	137	145	159	223	266	302	325	343	355	363	366
Net impairment expense	4	6	8	11	13	18	20	23	26	28	31
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	2	2	3	3	3
Share-based compensation	6	7	0	0	0	0	0	0	0	0	0
Interest expense	19	10	28	59	49	45	14	9	10	8	4
Interest income	(10)	(15)	(3)	(4)	(2)	(4)	(7)	(8)	(7)	(7)	(6)
Share of income in associates	0	0	(4)	(5)	(5)	(6)	(6)	(6)	(6)	(6)	(6)
Net change in other non-current assets	(2)	(7)	5	6	0	1	3	2	1	2	2
Other adjustments	(3)	1	(0)	(0)	(1)	(0)	(0)	(0)	(0)	(0)	(0)
Cash flows provided by operating activities, before change of turnover capital	856	1,129	1,520	1,929	2,409	3,513	3,910	4,294	4,696	4,995	5,268
Change of turnover assets	(46)	(160)	(176)	(185)	(240)	(391)	(234)	(251)	(273)	(261)	(286)
Change of turnover liabilities	14	95	46	52	68	116	65	70	76	72	78
Total effect of working capital changes	(32)	(66)	(131)	(134)	(172)	(275)	(169)	(181)	(197)	(189)	(208)
Income taxes paid	(212)	(236)	(352)	(435)	(553)	(836)	(943)	(1,041)	(1,144)	(1,220)	(1,292)
Net cash provided by operating activities	612	828	1,037	1,361	1,684	2,402	2,798	3,071	3,356	3,585	3,768
Cash flows from investing activities											
Purchases of property, plant and equipment	(174)	(803)	(965)	(972)	(968)	(753)	(692)	(639)	(580)	(528)	(525)
Net cash (used for) provided by investing activities	(174)	(803)	(965)	(972)	(968)	(753)	(692)	(639)	(580)	(528)	(525)
Cash flows from financing activities											
Proceeds from long-term borrowings	138	211	153	27	53	43	35	29	24	19	9
Proceeds from short-term borrowings	(164)	(33)	(179)	(165)	(71)	(57)	(47)	(38)	(31)	(39)	(19)
Repayments of long-term borrowings	99	0	306	55	0	15	17	17	3	2	2
Repayments of short-term borrowings	(274)	(89)	0	0	0	(294)	(50)	(0)	(14)	(16)	(16)
Interest paid	(11)	(4)	0	0	0	0	0	0	0	0	0
Dividends paid	(121)	(227)	(293)	(362)	(461)	(696)	(785)	(866)	(952)	(1,015)	(1,075)
Net cash (used for) provided by financing activities	(333)	(142)	(12)	(445)	(478)	(989)	(830)	(859)	(970)	(1,049)	(1,098)
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	(118)	60	(55)	238	660	1,276	1,573	1,806	2,009	2,146
Cash and cash equivalents at the beginning of the reporting period	109	219	163	228	167	393	1,031	2,263	3,772	5,496	7,370
Cash, cash equivalents at the end of the reporting period	209	101	223	173	406	1,053	2,306	3,836	5,578	7,505	9,516

Source: company's data; Estimation: Veles Capital

Financial analysis

Value forming estimates

	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Invested capital at years start, mn USD		-1.8	8.3	35.6	26.8	19.4	16.7	12.1	8.0	6.7	5.6	4.4	4.4
Growth of invested capital (IC), %	2,293.4	2,251.2	2,437.0	3,304.6	4,190.2	5,004.6	5,838.6	6,546.4	7,072.8	7,546.3	7,966.8	8,317.1	8,684.4
Share capital at years start, mn USD	1,549.0	2,024.3	2,518.2	3,183.4	3,858.8	4,699.0	5,780.0	7,437.6	9,308.0	11,405.8	13,750.8	16,287.6	19,018.6

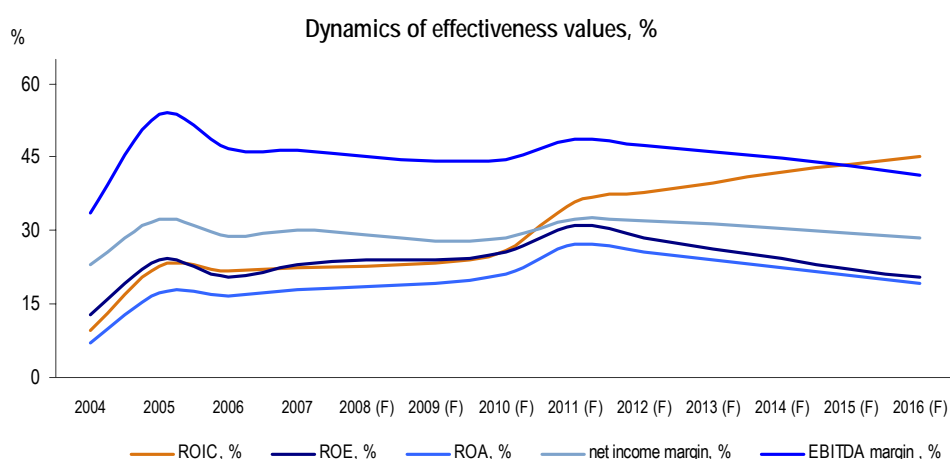
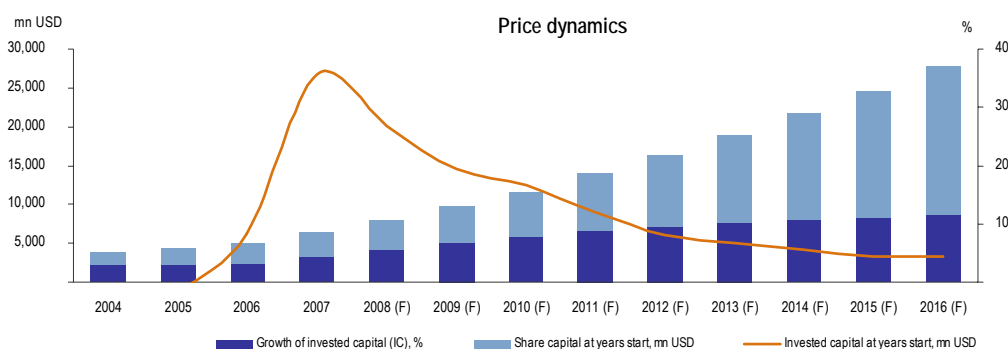
Business effectiveness analysis

	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
ROIC, %	9.6	22.7	21.8	22.4	22.7	23.3	26.0	35.8	37.8	39.8	42.1	43.6	45.0
ROE, %	12.8	23.9	20.6	23.0	24.1	24.0	25.6	31.1	28.6	26.3	24.3	22.2	20.5
ROA, %	6.9	17.4	16.7	18.0	18.4	19.2	21.2	27.2	25.7	23.9	22.4	20.7	19.2
EBITDA margin, %	33.5	53.8	46.9	46.4	45.0	44.3	44.6	48.5	47.5	46.2	44.8	43.2	41.4
EBIT margin, %	30.8	45.8	39.3	40.5	40.2	39.1	39.7	44.3	43.5	42.5	41.4	40.0	38.5
net income margin, %	23.0	32.5	28.9	30.1	29.1	27.9	28.6	32.2	32.0	31.2	30.5	29.4	28.3

Financial state analysis

	standard	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Financial leverage	< 0,7	0.54	0.16	0.05	0.08	0.14	0.10	0.07	0.02	0.01	0.01	0.01	0.00	0.00
liquidity estimates														
coverage ratio	> 2	0.45	0.75	1.68	0.60	0.78	0.91	1.44	2.54	4.53	6.61	8.61	10.76	12.59
current ratio	> 1	0.64	1.14	3.10	1.41	1.82	2.47	3.21	4.50	6.60	8.78	10.86	13.11	15.01
quick ratio	> 0,2	0.21	0.28	1.11	0.33	0.43	0.39	0.85	1.87	3.82	5.87	7.84	9.96	11.77
business activity estimates														
accounts receivable coverage period, days	< 45	50	41	21	19	19	19	19	19	19	19	19	19	19
turnover of supplies, days	< 102	14	12	16	10	10	11	11	10	10	10	10	10	11
use of own turnover capital		0.42	0.75	0.77	0.83	0.87	0.91	1.02	1.33	1.46	1.62	1.81	2.00	2.22

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)	11.05	11.51	11.09	11.27	11.27	11.27	11.27	11.27	11.27	11.27	11.27
Risk-free rate, %	5.84	5.84	5.41	5.60	5.60	5.60	5.60	5.60	5.60	5.60	5.60
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	1.03	1.45	1.45	1.45	1.45	1.45	1.45	1.45	1.45
Stock market risk, %	5.70	6.20	6.20	6.20	6.20	6.20	6.20	6.20	6.20	6.20	6.20
B Coefficient	0.92	0.92	0.92	0.92	0.92	0.92	0.92	0.92	0.92	0.92	0.92
Share of equity, %	95.6	92.5	88.0	91.3	93.1	98.2	99.0	99.1	99.4	99.7	99.9
Cost of debt (kd)	6.75	6.75	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25
Risk-free rate, %	5.84	5.84	5.41	5.60	5.60	5.60	5.60	5.60	5.60	5.60	5.60
Cost of debt, %	0.92	0.92	1.84	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65
Tax rate, %	28.90	26.50	26.50	26.50	26.50	26.50	26.50	26.50	26.50	26.50	26.50
Share of debt, %	4.35	7.51	12.00	8.71	6.94	1.84	0.99	0.87	0.59	0.27	0.10
WACC	10.78	11.02	10.40	10.76	10.86	11.16	11.21	11.22	11.24	11.26	11.27

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	1,133	1,531	1,912	2,395	3,493	3,886	4,267	4,667	4,963	5,232
Amortization and depreciation	135	144	162	223	266	302	325	343	355	363	366
EBIT	706	989	1,370	1,689	2,129	3,190	3,560	3,924	4,312	4,599	4,866
Income tax	(204)	(286)	(357)	(435)	(553)	(836)	(943)	(1,041)	(1,144)	(1,220)	(1,292)
after-tax EBITDA	638	847	1,174	1,478	1,842	2,657	2,942	3,226	3,524	3,742	3,940
CapEx	(164)	(745)	(981)	(972)	(968)	(753)	(692)	(639)	(580)	(528)	(525)
Change of operating capital	(32)	(66)	(133)	(134)	(172)	(275)	(169)	(181)	(197)	(189)	(208)
FCF	472	73	61	366	698	1,627	2,091	2,417	2,757	3,037	3,220

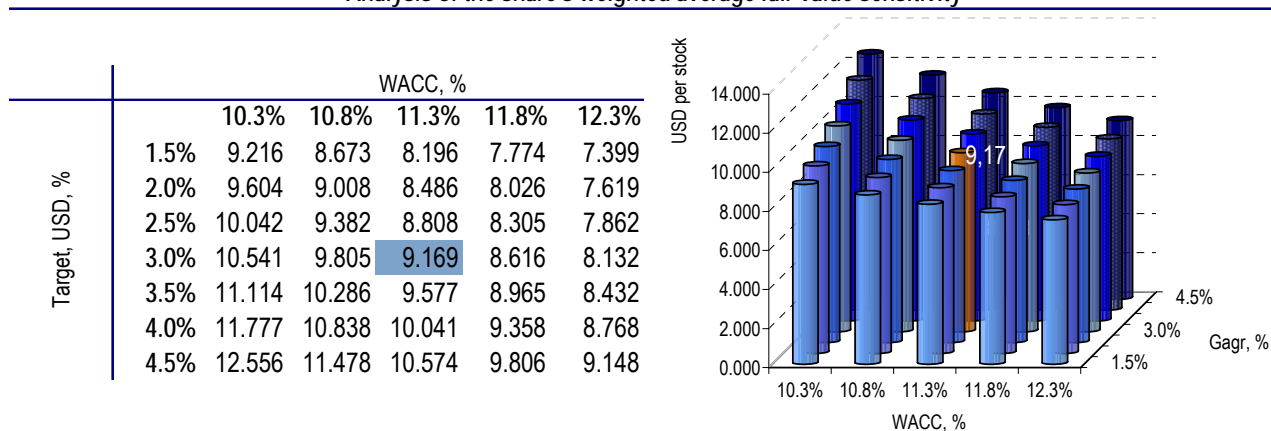
Source: company's data, Estimation: Veles Capital

NOVATEK's stocks valuation

TGR, %	3.00
Terminal value, mn USD	46,551
Discounted terminal value, mn USD	17,808
Enterprise value, mn USD	27,950
Net debt, mn USD	109
Shareholder's equity (incl. minority interest), mn USD	27,841
Number of shares, mn units	3,036,306,000
Fair value of common stock at the year end, USD	9.169
Upside (downside) of common stock, %	18.77

Source: company's data, Estimation: Veles Capital

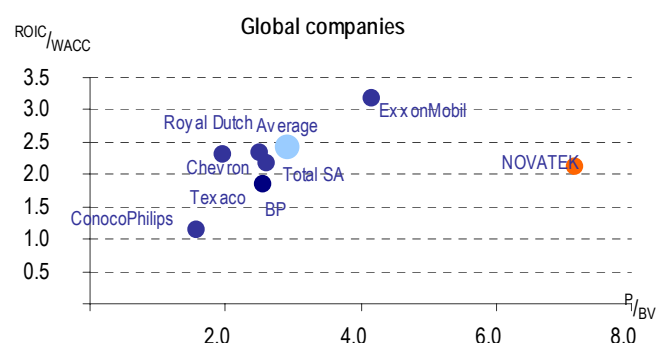
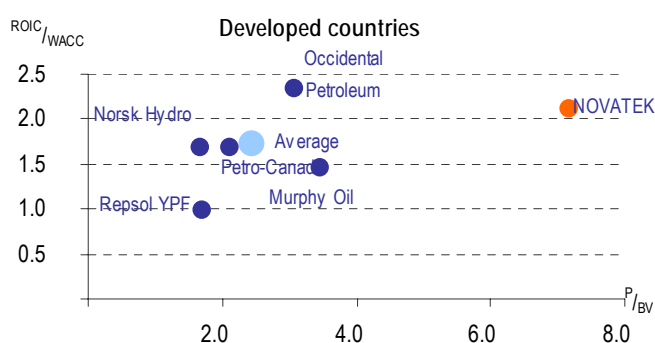
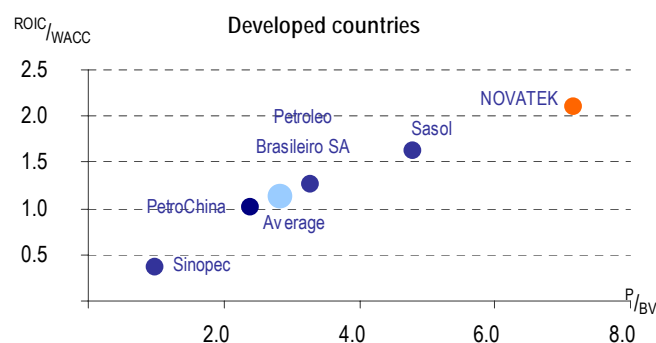
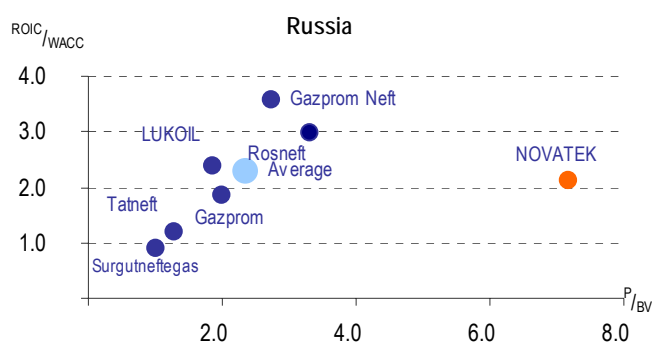
Analysis of the share's weighted average fair value sensitivity



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	318,409	3.27	12.21	9.23	2.01	21.28	12.70	16.51	8.89	1.86
LUKOIL	Russia	LKOH RU	78,337	1.14	8.02	5.50	1.85	25.67	17.63	22.46	9.50	2.36
Gazprom Neft	Russia	SIBN RU	28,116	1.46	7.54	5.26	2.73	41.63	29.59	36.09	10.15	3.56
Surgutneftegas	Russia	SNGS RU	39,608	1.61	10.62	-	1.01	9.83	9.15	9.71	10.84	0.90
Tatneft	Russia	TATR RU	14,458	0.98	10.86	5.88	1.30	13.84	9.90	13.59	11.30	1.20
TNK-BP	Russia	TNBP RU	30,901	1.32	4.56	-	2.55	73.96	31.86	60.87	10.50	5.80
Transneft	Russia	TRNFP RU	7,899	0.64	2.96	3.20	0.34	15.09	10.38	13.94	9.86	1.41
Rosneft	Russia	ROSN RU	104,286	1.96	18.81	9.32	3.32	51.13	21.16	29.45	9.86	2.99
NOVATEK	Russia	NVTK RU	24,139	9.86	34.28	24.42	7.17	22.42	17.27	20.78	9.86	2.11
Russia average				2.69	12.78	9.01	2.35	29.13	16.18	21.94	9.47	2.29
PetroChina	China	857 HK	400,123	2.08	11.93	10.63	2.41	22.06	15.07	20.44	20.15	1.01
Petroleo Brasileiro SA	Brazil	PETRA BZ	253,472	2.19	17.40	9.62	3.29	20.35	9.74	16.07	12.84	1.25
Sasol	SAR	SOL SJ	37,731	2.43	16.65	-	4.80	29.82	15.33	23.82	14.73	1.62
Sinopec	China	338 HK	5,706	0.37	12.32	18.31	0.98	8.25	5.71	7.45	20.20	0.37
Emerging markets average				2.12	14.18	10.31	2.85	21.75	13.07	18.93	17.20	1.13
Murphy Oil	USA	MUR US	17,589	0.95	21.46	10.30	3.47	16.69	8.51	13.46	9.30	1.45
Norsk Hydro	Norway	NHY NO	18,301	0.69	6.73	-	1.69	24.17	11.16	21.40	12.77	1.68
Occidental Petroleum	USA	OXY US	69,693	3.75	16.06	6.77	3.07	25.67	15.66	24.14	10.30	2.34
Petro-Canada	Canada	PCA CN	24,955	1.17	10.52	3.84	2.12	24.50	11.76	19.69	11.69	1.68
Repsol YPF	Spain	REP SM	50,301	0.56	9.79	5.22	1.71	17.74	6.90	10.92	11.06	0.99
Developed markets average				1.92	13.13	6.22	2.46	22.28	11.53	18.53	10.86	1.72
BP	UK	BP/ LN	217,143	0.79	10.59	6.51	2.57	23.39	9.19	18.64	10.11	1.84
Chevron Texaco	USA	CVX	192,508	0.96	10.77	5.59	2.51	25.60	13.28	23.11	9.89	2.34
ConocoPhillips	USA	COP	134,066	0.80	8.68	5.07	1.59	13.86	6.94	11.33	10.06	1.13
ExxonMobil	USA	XOM US	504,294	1.45	12.95	6.92	4.17	34.47	17.61	32.47	10.19	3.19
Royal Dutch	Holland	RDSA LN	241,281	0.68	7.70	4.67	1.97	27.28	12.41	23.75	10.29	2.31
Total SA	France	FP FP	198,769	0.86	8.92	4.49	2.61	30.95	12.05	22.81	10.53	2.17
Global average				1.03	10.55	5.83	2.92	28.21	13.27	24.63	10.19	2.42

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



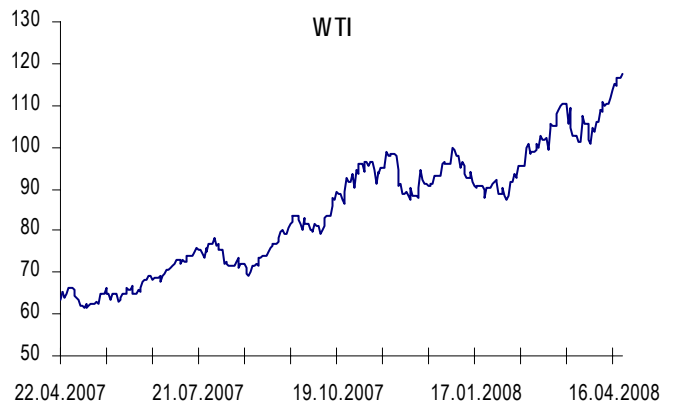
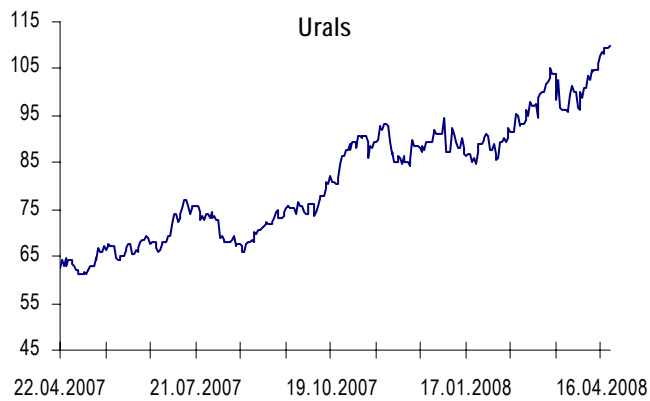
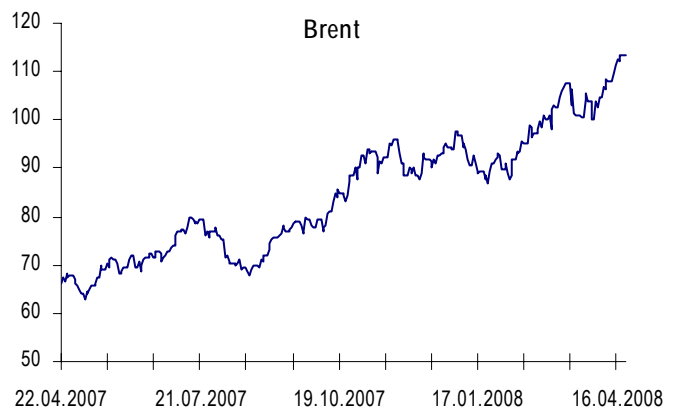
Source: Bloomberg; Estimation: Veles Capital

Commodity markets

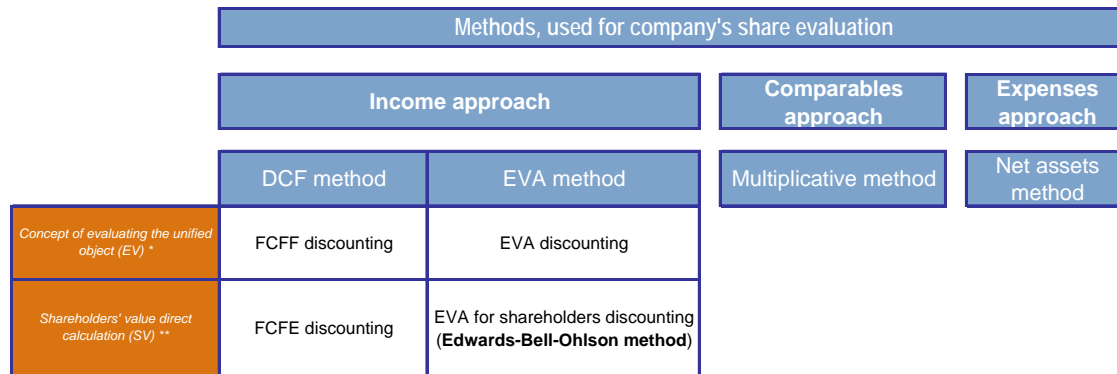
Current oil prices

		Close. USD	Change. USD	Change. %					Current year. USD	
				day	week	month	from Jan 1	year	min	max
Light. USD / bbl	▲	114.32	0.57	0.50	4.91	13.28	19.21	73.26	86.75	114.32
Brent. USD / bbl	▲	113.55	0.01	0.01	3.71	12.69	20.94	71.19	85.05	113.94
Urals. USD / bbl	▲	109.89	0.57	0.52	3.60	14.02	20.39	75.60	82.80	109.89
WTI. USD / bbl	▲	117.48	0.79	0.68	5.12	14.29	22.38	85.36	86.47	117.48
Brent-Urals	▼	3.66	-0.56	-13.27	7.02	-16.44	40.23	-2.40	1.81	9.94

Oil prices charts



Brief investor's guide



*

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

$$FCFE = \text{gross shareholders' cash flow} - \text{gross investments}$$

$$\text{Gross shareholders' cash flow} = EAT \text{ of operational profit (including interest payoffs) - annual debt coverage} + \text{attracted borrowed assets} + \text{amortization}$$
- 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.

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