Veles Capital

Investment company

Research
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Transneft

Recommendation: BUY

After merging with Transnefteproduct

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Bullet moments

- On September 29th, Transneft published its financial results under IAS 1Q 2008 report, above market expected results, influencing company's stocks.
- Transneft's net income over 1Q 2008 increased by 40.4% and formed 22.554 bn RUR against 1Q 2007 results (16.062 bn RUR), says company's report. Net income of the company exceeded our expectations by 21%.
- Over 1Q 2008 company's revenue added +17.1% against 1Q 2007 results and formed 63.623 bn RUR. We expect that company's income over year 2008 could form 69 bn RUR. A significant growth of net income and slight growth of company's revenue demonstrates a growth of efficiency of operating results and proves a restrained growth of expenses over financial period.
- EBITDA margin totaled 59.6% and exceeded last year results by 2.7 p.p., operating income margin formed 47.2% in comparison with 1Q 2007 results (43.9%). Net income of the company increased by 5.5 p.p. and reached 36.4%.
- We have put some corrections in Transneft's model. In particular, we have specified a forecast of macroeconomical indicators of Russia over next several years. We also put some corrections in growth of oil extraction rate of RF and Transneft's product turnover as well. We decreased the forecast of oil extraction rate of Russia by 2.5% over 2008-2016. According to our forecasts, an average growth of extraction rate could form 1.3% vs 1.6% (prior forecasts). We also corrected Transneft's operating expenses flow, due to merge with Transnefteproduct and a fall of sales volumes and resale crude oil in 1Q 2008. Regarding the last change we can say that a fall of resale crude oil also has a negative effect on company's revenue over forecasted period and target price of the company, due to decreased investments in the company. It should be mentioned that our previous forecasts indicated higher results of Transnefteproduct's revenue growth than over 1Q 2008 results.
- In our model, we tried to reflect consequences of global financial system crisis towards Russian economy, leading to a growth of Transneft's weighted average price from 12.9% to 13.4%, decreasing company's estimation.
- On the base of published results, we estimated a new fair price of Transneft's preferred stocks, forming 1,988 USD vs prior estimation – 2.275 USD per share (-12.61%). Today a growth potential of company's stocks exceeds 180%. We confirm "BUY" recommendation on Transneft's securities.

Principal estimates

Company's shares dynamics vs RTS

Information about Transneft	
Ticker	TRNFP
Market price, USD (pref)	710
Min / max price during last year, USD (pref)	420 / 2 007
Fair price at year end, USD (pref)	1,988
Upside (downside) (pref), %	*180.02*
Total shares, units	6,219,502
MC, mn USD	4,416
EV, mn USD	9,864

Financial values (IAS)	2007	2008 (F)	2009 (F)
Sales, mn USD	8,687	10,925	12,311
EBITDA, mn USD	4,912	6,437	7,216
Net income, mn USD	2,354	3,441	3,576
EBITDA margin, %	*56.5*	*58.9*	*58.6*
Net income margin, %	*27.1*	*31.5*	*29.0*

Financial coefficients	2007	2008 (F)	2009 (F)
P/E	1.9	1.3	1.2
P/S	0.51	0.40	0.36
EV/S	1.13	1.05	1.02
EV/EBITDA	2.01	1.79	1.74
ROIC/WACC	1.5	1.5	1.3

Transneft's 1Q 2008 results

Transneft's net income of 1Q 2008 under IAS has increased +40.4% versus prior year (16.062 bn RUR) and formed 22.554 bn RUR, states company's report. Company's net income exceeded our forecast by +21%.

Company's sales of 1Q 2008 expanded +17.1% versus year 2007, and formed 63.623 bn RUR. Whereas we have expected the company to demonstrate a 69 bn RUR worth of income during the reported period. Therefore, considering a significant growth net income versus a rather slow sales growth rate – this reflects in improvement of operating effectiveness and indicates a moderate growth of costs throughout the highlighted term. EBITDA margin has formed 59.6%, or +2.7 p.p. above the similar term of past year, operating income margin has formed 47.2% versus 43.9% in 1Q 2007. Net income margin has expanded +5.5 p.p. up to 36.4% throughout the reported term. The growth of effectiveness was boosted by the outrunning growth of sales (+17.1%) versus costs growth rate, which barely formed 11.4%. Although, company has sharply reduced insurance-relate costs (-50.3%) and purchased oil costs (-88.3%), the latter expenses item has been reduced, due to decrease of purchased oil from oil companies.

We would like to take a closer notice of Transneft's growing sales. The expansion of +17.1% became possible thanks to increased tariffs of oil transportation +19.4% since January 1st 2008 and beginning of Transnefteproduct's results representation within company's report. Do remember – Transnefteproduct was united with Transneft at the base of latter.

Transneft's short-term liabilities of 1Q 2008 have increased +2.2% versus past year, and as of March 31st 2008 have formed 132.296 bn RUR. However, the value of short credits and loans and leasing liabilities has been reduced -1.8% to 89.605 bn RUR. The long-term liabilities have expanded to 191.641 bn RUR, or +16.75%, mostly due to expansion of long-term loans for construction of VSTO and lesser infrastructure projects, and growth of reserves for upcoming payments and expenses. The positive aspect for shareholders is reduction of capital investments in 1Q 2008, at exactly 2 times versus prior year's 1Q, which on its part stimulated the growth of free cash flow and overall appraisal of the company.

We see the issued report of Transneft as quite positive for company and its equity. We would also like you to take note of Transnefteproduct's integration, which had positively supported Transneft's financials. The company also issued a 14.4% of its oil surplus income for charity purposes, effectively reducing this value from 34.8% spent during the 1Q 2007, which possibly indicates a new, more balanced policy for spending of additional income ("the gifts from the oilmen"). Under the new CEO – Nikolai Tokarev, Transneft may possibly engage in charity again, but this time taking into account other results of company's activities (including various non-operating expenses) and costs related to the construction of VSTO.

Inter-segment sales, mn RUR

	1Q 2007	Chg., %	1Q 2008	4Q 2007	Chg., %	1Q 2008
Sales off oil transfer services						
Domestic market	20,132	*27.3*	25,618	20,460	*25.2*	25,618
Export	28,981	*11.7*	32,377	29,097	*11.3*	32,377
Total	49,113	*18.1*	57,995	49,557	*17.0*	57,995
Oil products transfer services	-	*n/m*	2,621	-	*n/m*	2,621
Oil sales	3,416	*-90.9*	311	6,294	*-95.1*	311
Other sales	-	*n/m*	84	-	*n/m*	84
Other sales	1,814	*44.0*	2,612	1,542	*69.4*	2,612
Sales total	54,343	*17.1*	63,623	57,393	*10.9*	63,623

Source: Company's data; Estimation: Veles Capital

Transneft's financial results, IAS 1Q 2008, mn RUR

	1Q 2007	Chg., %	1Q 2008	4Q 2007	Chg., %	1Q 2008
Sales	54,343	*17.1*	63,623	57,393	*10.9*	63,623
Operating costs	(31,992)	*11.4*	(35,647)	(37,641)	*-5.3*	(35,647)
Amortization	(7,035)	*12.6*	(7,918)	(7,613)	*4.0*	(7,918)
Staff costs	(7,375)	*42.2*	(10,485)	(8,064)	*30.0*	(10,485)
Electric power	(5,141)	*15.3*	(5,930)	(5,052)	*17.4*	(5,930)
Materials	(2,107)	*33.0*	(2,803)	(2,354)	*19.1*	(2,803)
Cost of oil sold	(3,522)	*-88.3*	(411)	(5,194)	*-92.1*	(411)
Insurance costs	(2,789)	*-50.3*	(1,386)	(1,672)	*-17.1*	(1,386)
Reserve expenses on bad debt	-	*n/m*	(2,698)	-	*n/m*	(2,698)
Costs of repair and maintenance of oil pipelines	(899)	*-6.3*	(842)	(1,382)	*-39.1*	(842)
Administrative expenses	(825)	*18.4*	(977)	(895)	*9.2*	(977)
Transport expenses	(394)	*4.8*	(413)	(501)	*-17.6*	(413)
Taxes, excluding income tax	(406)	*5.7*	(429)	(422)	*1.7*	(429)
Other	(1,499)	*-9.6*	(1,355)	(4,492)	*-69.8*	(1,355)
Other operating income/expense	1,487	*36.1*	2,024	8,531	*-76.3*	2,024
Operating income	23,838	*25.8*	30,000	28,283	*6.1*	30,000
Operating income margin, %	*43.9*		*47.2*	*49.3*		*47.2*
EBITDA	30,873	*22.8*	37,918	35,896	*5.6*	37,918
EBITDA margin, %	*56.8*		*59.6*	*62.5*		*59.6*
Interest receivable	64	*328.1*	274	65	*321.5*	274
Interest payable	(393)	*46.6*	(576)	(885)	*-34.9*	(576)
Gain (loss) on currency exchange	281	*419.9*	1,461	295	*395.3*	1,461
Others	-	*n/m*	(15)	(38)	*-60.5*	(15)
Income before tax	23,790	*30.9*	31,144	27,720	*12.4*	31,144
Income before tax margin, %	*43.8*		*49.0*	*48.3*		*49.0*
Current income tax	(6,416)	*43.1*	(9,181)	(7,501)	*22.4*	(9,181)
Deferred income tax	(558)	*n/m*	1,214	(1,483)	*n/m*	1,214
Net income	16,816	*37.8*	23,177	18,736	*23.7*	23,177
Net income margin, %	*30.9*		*36.4*	*32.6*		*36.4*
Minority interest	754	*-17.4*	623	1,632	*-61.8*	623
Net income excluding minority interest	16,062	*40.4*	22,554	17,104	*31.9*	22,554

Source: Company's data; Estimation: Veles Capital

New forecasts and estimations

We have put some corrections in Transneft's model. In particular, we specified a forecast of macroeconomical indicators of Russia (GDP, inflation, energy tariffs) over next several years. The forecasted results have slightly changed, excluding the expected results for 2008-2009, which we have increased, taking into account the estimations of Russian government and various financial institutes, concerning growth rates of GDP and inflation and real results of macroeconomical indicators over 1H 2008.

We also put some corrections in growth of oil extraction rate of RF and Transneft's products turnover as well. We decreased the forecast of oil extraction rate of Russia by 2.5% over 2008-2016. According to our estimations, an average growth of extraction rate could form 1.3% vs 1.6% (prior forecasts). The fall occurred due to decreased extraction rate of some large oil deposits of Russia over the year and growth expectations over next 8 years. The expectations were changed due to delays of 1st stage launch of ESPO pipeline (until late 2009), leading to delays of large deposits launch in Western Siberia. Among them are: Talanskoye deposit (Surgutneftegas), Verkhnechonskoye deposit (TNK-BP) and Vankorskoye deposit (Rosneft). Settled financial crisis can have a negative effect on launch and development of new deposits, which can put some negative corrections in investment programs of some oil companies.

We have not changed Transneft's CapEx, but taking into account 1Q 2008 results, capital investments decreased by 44%. However, we took into account capital investments towards company's assets, which are under construction and maintenance of oil pipeline system over next several years.

We also corrected Transneft's operating expenses flow, due to merge with Transnefteproduct and a fall of sales volumes and repurchased crude oil in 1Q 2008. Regarding the last change we can say that a fall of repurchased crude oil also has a negative effect on company's revenue over forecasted period and target price of the company, due to decreased investments in the company. It should be mentioned that our previous forecasts indicated higher results of Transnefteproduct's revenue growth than over 1Q 2008 results.

In our model, we tried to reflect consequences of crisis of global financial system towards Russian economy, leading to a growth of Transneft's weighted average price from 12.9% to 13.4%, decreasing company's estimation.

In total, we see Transneft's stocks as strongly underestimated in accordance with the current fundamental indicators. We think that when the 1st stage of ESPO pipeline is constructed, Transneft can increase dividends payments. Let us remind you that dividends are formed on the base of income, reflected in RAS report, whereas company's RAS 1Q 2008 report indicates Transneft's income of 5% form consolidated. Such situation in dividends policy can be a sound growth driver for company's stocks, making them more attractive for scared shareholders.

On the base of published results, we estimated a new fair price of Transneft's preferred stocks, forming 1,988 USD vs prior estimation – 2.275 USD per share (-12.61%). Today a growth potential of company's stocks exceeds 180%. We confirm "BUY" recommendation on Transneft's securities.

Financial model

Transneft's balalance sheet, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
ASSETS											
Long-term assets	18,408	24,863	30,656	35,427	37,552	38,662	39,733	40,624	41,423	42,148	42,715
Intangible assets	21	36	45	52	55	57	58	59	61	62	63
PPE	18,342	24,797	30,574	35,333	37,453	38,559	39,626	40,513	41,308	42,029	42,593
Financial investments, available for sale	45	30	37	42	44	46	49	52	54	57	59
Short-term assets	2,812	4,199	5,909	6,266	6,623	7,939	7,325	7,269	7,965	10,473	13,390
Reserves	309	387	429	503	557	594	638	679	717	761	801
Debitors and loans issued	536	823	1,035	1,167	1,226	1,285	1,370	1,446	1,515	1,591	1,657
Current VAT tax assets	866	1,990	2,209	2,591	2,864	3,059	3,285	3,493	3,691	3,914	4,122
Current income tax assets	14	46	48	50	48	47	46	45	44	43	43
Financial investments, available for sale	8	33	42	47	49	52	55	58	61	64	67
Cash and equivalents	1,080	920	2,144	1,908	1,878	2,902	1,932	1,549	1,936	4,100	6,701
Total assets	21,221	29,062	36,565	41,692	44,175	46,600	47,058	47,893	49,388	52,621	56,105
Liabilities											
Equity	13,536	16,692	20,849	24,859	27,696	30,413	33,572	36,974	40,591	44,390	48,148
Authorized capital	11	12	13	13	12	12	12	12	11	11	11
Added capital	0	0	2,145	2,190	2,132	2,065	2,021	1,983	1,950	1,921	1,887
Reserve due to merging	0	0	(534)	(545)	(531)	(514)	(503)	(494)	(485)	(478)	(470)
Retained earnings	13,524	16,680	19,225	23,202	26,082	28,850	32,042	35,473	39,115	42,935	46,720
Minority interest	660	879	1,072	1,271	1,422	1,572	1,745	1,930	2,127	2,336	2,544
Long-term liabilities	3,166	6,425	9,570	10,650	10,499	10,372	7,737	5,221	3,136	2,571	2,306
Long-term liabilities	62	2,791	6,040	7,285	7,430	7,581	5,165	2,839	919	498	368
Deffered tax	962	1,150	1,200	1,225	1,192	1,155	1,130	1,109	1,091	1,075	1,055
Reserves for future payments	2,142	2,483	2,330	2,141	1,876	1,635	1,441	1,272	1,126	998	882
Short-term liabilities	3,859	5,067	5,073	4,912	4,558	4,244	4,004	3,768	3,534	3,325	3,107
Trade and various creditors	1,241	1,404	1,766	1,989	2,091	2,191	2,335	2,466	2,583	2,712	2,825
Current income tax liabilities	68	91	115	129	136	142	152	160	168	176	183
Short-term liabilities and current share of long-term loans	2,551	3,572	3,193	2,794	2,331	1,911	1,517	1,143	783	436	99
Total liabilities	7,025	11,491	14,643	15,562	15,057	14,616	11,741	8,989	6,670	5,896	5,413
Total equity and liabilities	21,221	29,062	36,565	41,692	44,175	46,600	47,058	47,893	49,388	52,621	56,105

Source: company's data; Estimation: Veles Capital

Income and loss statements of Transneft, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
Sales	7,461	8,687	10,925	12,311	12,937	13,559	14,451	15,258	15,986	16,785	17,480
Costs	(4,232)	(5,322)	(5,907)	(6,929)	(7,659)	(8,180)	(8,784)	(9,340)	(9,871)	(10,466)	(11,023)
EBITDA	3,830	4,912	6,437	7,216	7,446	7,653	8,025	8,339	8,589	8,849	9,024
EBITDA margin, %	*51.3*	*56.5*	*58.9*	*58.6*	*57.6*	*56.4*	*55.5*	*54.7*	*53.7*	*52.7*	*51.6*
Depreciation	806	1,181	1,306	1,717	2,064	2,177	2,265	2,333	2,390	2,442	2,476
EBIT	3,023	3,731	5,131	5,499	5,382	5,476	5,760	6,006	6,198	6,406	6,548
EBIT margin, %	*40.5*	*43.0*	*47.0*	*44.7*	*41.6*	*40.4*	*39.9*	*39.4*	*38.8*	*38.2*	*37.5*
Currency exchange rate gain	(2)	71	60	24	23	25	26	31	35	30	26
Interest receivable	29	11	29	44	37	36	57	38	30	38	81
Interest payable	(71)	(89)	(186)	(353)	(368)	(355)	(348)	(246)	(147)	(126)	(69)
EBT	2,979	3,723	5,032	5,211	5,072	5,180	5,492	5,826	6,114	6,345	6,582
EBT margin, %	*39.9*	*42.9*	*46.1*	*42.3*	*39.2*	*38.2*	*38.0*	*38.2*	*38.2*	*37.8*	*37.7*
Income tax	(957)	(1,192)	(1,434)	(1,459)	(1,395)	(1,399)	(1,483)	(1,573)	(1,651)	(1,713)	(1,777)
Minority interest	(120)	(177)	(156)	(176)	(185)	(194)	(207)	(218)	(229)	(240)	(250)
Net income	1,902	2,354	3,441	3,576	3,492	3,588	3,803	4,035	4,235	4,392	4,555
Net income margin, %	*25.5*	*27.1*	*31.5*	*29.0*	*27.0*	*26.5*	*26.3*	*26.4*	*26.5*	*26.2*	*26.1*

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)	*12.41*	*13.32*	*13.48*	*13.48*	*13.48*	*13.48*	*13.48*	*13.48*	*13.48*	*13.48*	*13.48*
Risk-free rate	*5.41*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*
10 year US Treasures yeld	*4.35*	*4.15*	*4.15*	*4.15*	*4.15*	*4.15*	*4.15*	*4.15*	*4.15*	*4.15*	*4.15*
Russia risk	*1.06*	*1.60*	*1.60*	*1.60*	*1.60*	*1.60*	*1.60*	*1.60*	*1.60*	*1.60*	*1.60*
Stock market risk	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*	*5.00*
Coefficient b	0.90	1.01	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
Corporate risk	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*	*2.50*
Share of equity, %	*83.8*	*72.4*	*69.3*	*71.2*	*73.9*	*76.2*	*83.4*	*90.3*	*96.0*	*97.9*	*99.0*
Cost of debt (kd)	*7.00*	*7.00*	*7.00*	*7.50*	*7.50*	*7.50*	*7.50*	*7.50*	*7.50*	*7.50*	*7.50*
Risk-free rate	*5.41*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*	*5.75*
Debt premium	*1.59*	*1.25*	*1.25*	*1.75*	*1.75*	*1.75*	*1.75*	*1.75*	*1.75*	*1.75*	*1.75*
Tax rate	*32.13*	*32.00*	*28.50*	*28.00*	*27.50*	*27.00*	*27.00*	*27.00*	*27.00*	*27.00*	*27.00*
Share of debt, %	*16.18*	*27.60*	*30.69*	*28.85*	*26.06*	*23.79*	*16.60*	*9.72*	*4.03*	*2.06*	*0.96*
WACC	*11.17*	*10.95*	*10.88*	*11.15*	*11.38*	*11.58*	*12.15*	*12.70*	*13.16*	*13.32*	*13.40*

Source: company's data; Estimation: Veles Capital

Cash flows of Transneft, mn USD

	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
EBITDA	3,830	4,912	6,598	7,246	7,446	7,653	8,025	8,339	8,589	8,849	9,024
Amortization and depreciation	806	1,181	1,339	1,724	2,064	2,177	2,265	2,333	2,390	2,442	2,476
EBIT	3,023	3,731	5,260	5,522	5,382	5,476	5,760	6,006	6,198	6,406	6,548
Income tax	(971)	(1,194)	(1,499)	(1,546)	(1,480)	(1,479)	(1,555)	(1,622)	(1,674)	(1,730)	(1,768)
EBITDA after tax	2,052	2,537	3,761	3,976	3,902	3,998	4,205	4,385	4,525	4,677	4,780
CapEx	5,596	5,720	6,172	5,863	5,116	4,460	4,147	3,967	3,862	3,767	3,795
Decrease/(increase) of turnover capital	(232)	1,334	23	318	338	265	261	243	235	255	259
FCF	(2,970)	(668)	(1,049)	154	1,187	1,979	2,583	2,993	3,288	3,606	3,721

Source: company's data, Estimation: Veles Capital

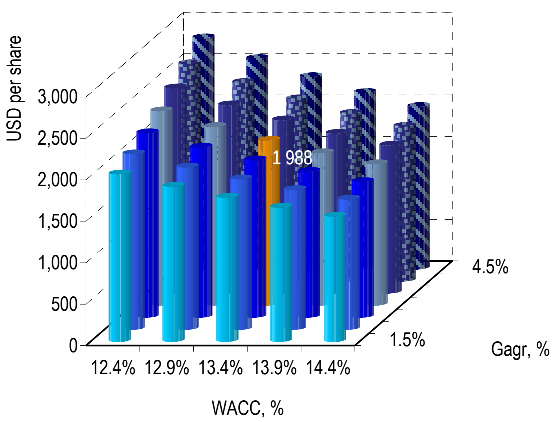
Transneft's stock valuation

TGR, %	*3.00*
Discount rate, %	*13.40*
Termimal value, mn USD	34,589
Discounted terminal value, mn USD	11,151
Enterprise value, mn USD	17,813
Net debt, mn USD	5,448
Shareholer's equity, mn USD	12,365
Number of shares, mn units	4,664,627
Number of preferred shares, mn units	1,554,875
Fair value of preferred stock at the year end, USD	1,988
Upside (downside), %	*180.02*

Source: company's data, Estimation: Veles Capital

Analysis of the share's weighted average fair value sensitivity

Growth rate in postforecasted period, %	WACC, %				
	12.4%	12.9%	13.4%	13.9%	14.4%
1.5%	2,021	1,872	1,739	1,620	1,511
2.0%	2,118	1,958	1,815	1,687	1,571
2.5%	2,225	2,052	1,898	1,760	1,636
3.0%	2,343	2,155	1,988	1,839	1,707
3.5%	2,475	2,269	2,088	1,927	1,784
4.0%	2,622	2,396	2,198	2,023	1,868
4.5%	2,788	2,539	2,321	2,130	1,961



Source: estimation of 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), %	*39.4*	*46.9*	*26.2*	*18.2*	*7.7*	*4.0*	*3.6*	*2.8*	*3.4*	*7.2*	*10.5*
Invested capital (IC), %	15,069	22,136	27,937	33,029	35,579	37,003	38,324	39,407	40,745	43,684	48,280
Equity, mn USD	13,536	16,692	20,849	24,859	27,696	30,413	33,572	36,974	40,591	44,390	48,148

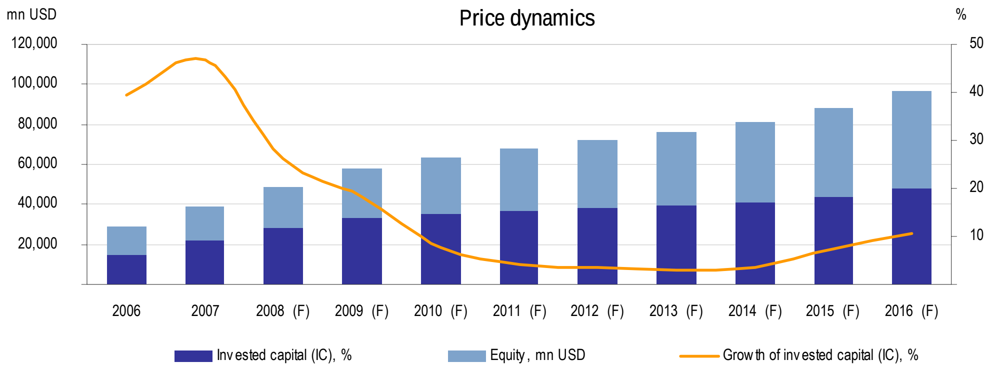
Business effectiveness analysis

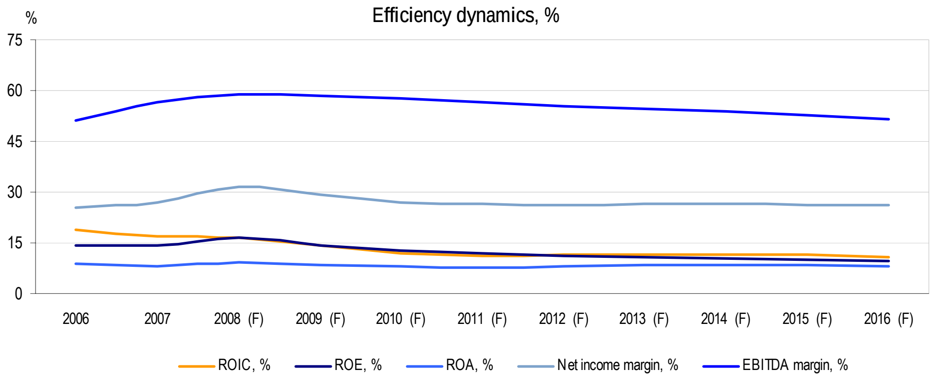
	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)	2016 (F)
ROIC, %	*19.0*	*16.8*	*16.6*	*14.2*	*11.8*	*11.2*	*11.4*	*11.4*	*11.5*	*11.5*	*10.9*
ROE, %	*14.1*	*14.1*	*16.5*	*14.4*	*12.6*	*11.8*	*11.3*	*10.9*	*10.4*	*9.9*	*9.5*
ROA, %	*9.0*	*8.1*	*9.4*	*8.6*	*7.9*	*7.7*	*8.1*	*8.4*	*8.6*	*8.3*	*8.1*
EBITDA margin, %	*51.3*	*56.5*	*58.9*	*58.6*	*57.6*	*56.4*	*55.5*	*54.7*	*53.7*	*52.7*	*51.6*
EBIT margin, %	*40.5*	*43.0*	*47.0*	*44.7*	*41.6*	*40.4*	*39.9*	*39.4*	*38.8*	*38.2*	*37.5*
Net income margin, %	*25.5*	*27.1*	*31.5*	*29.0*	*27.0*	*26.5*	*26.3*	*26.4*	*26.5*	*26.2*	*26.1*

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	0.19	0.38	0.44	0.41	0.35	0.31	0.20	0.11	0.04	0.02	0.01
liquidity estimates											
coverage ratio	0.65	0.75	1.08	1.17	1.33	1.73	1.67	1.75	2.05	2.92	4.05
current ratio	0.73	0.83	1.16	1.28	1.45	1.87	1.83	1.93	2.25	3.15	4.31
quick ratio	0.28	0.19	0.43	0.40	0.42	0.70	0.50	0.43	0.57	1.25	2.18
business activitiy estimates											
accounts receivable coverage period, days	26	34	34	34	34	34	34	34	34	34	34
turnover of supplies, days	15	16	14	15	15	16	16	16	16	16	16
use of own turnover capital	(7.13)	(10.02)	13.07	9.09	6.27	3.67	4.35	4.36	3.61	2.35	1.70

Source: company's data; Estimation: Veles Capital





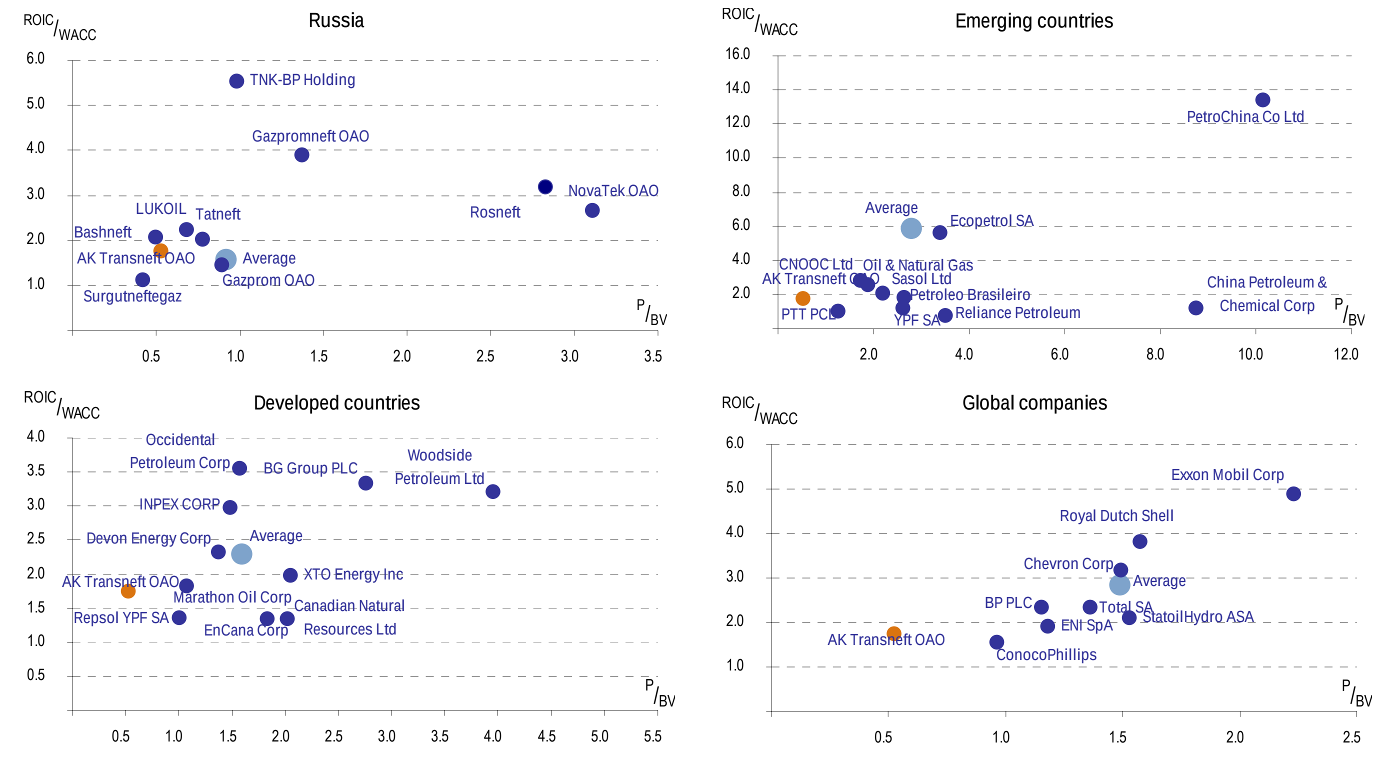
Public comparables

Sector companies' multipliers and coefficients

	Country	Current capitalization, mln USD	Enterprise value, mln USD	Market multipliers					*Financial coefficients*				
				EV/S	EV/EBITDA	P/E	P/BV	EV/IC	*ROE, %*	*ROA, %*	*ROIC, %*	*EBITDA margin, %*	*ROIC/WACC*
Global companies													
Exxon Mobil Corp	UNITED STATES	384,668	371,268	0.59	3.72	8.11	2.23	2.34	*35.32*	*28.44*	*49.60*	*15.95*	*4.88*
Chevron Corp	UNITED STATES	159,222	158,871	0.53	2.97	6.57	1.50	1.50	*27.87*	*20.64*	*31.93*	*17.98*	*3.17*
ConocoPhillips	UNITED STATES	105,338	122,468	0.48	2.74	5.50	0.97	0.97	*19.64*	*14.28*	*15.85*	*17.47*	*1.54*
BP PLC	BRITAIN	154,430	179,231	0.46	3.11	5.35	1.15	1.13	*27.21*	*11.78*	*23.38*	*14.88*	*2.34*
Royal Dutch Shell PLC	NETHERLANDS	178,011	186,984	0.39	2.71	5.46	1.57	1.53	*23.75*	*16.14*	*40.53*	*14.23*	*3.81*
Total SA	FRANCE	139,037	155,484	0.61	2.83	6.49	1.36	1.31	*29.75*	*13.31*	*23.16*	*21.66*	*2.33*
ENI SpA	ITALY	104,365	128,422	0.86	2.94	6.32	1.18	1.14	*25.83*	*12.97*	*19.35*	*29.25*	*1.91*
StatoilHydro ASA	NORWAY	72,611	75,863	0.64	1.61	6.04	1.53	1.50	*34.12*	*12.65*	*30.23*	*39.91*	*2.08*
Glabal companies weighted average		162,210	172,324	0.54	2.93	6.42	1.49	1.45	*28.22*	*16.86*	*29.37*	*17.61*	*2.83*
Developed markets													
Occidental Petroleum Corp	UNITED STATES	53,110	51,491	2.04	2.95	6.21	1.58	1.61	*32.58*	*25.96*	*35.62*	*69.17*	*3.55*
Devon Energy Corp	UNITED STATES	38,931	40,593	2.61	3.62	7.70	1.37	1.35	*20.63*	*16.13*	*20.23*	*71.93*	*2.32*
Transocean Inc	UNITED STATES	34,219	47,361	3.74	6.67	7.27	1.74	1.44	*29.94*	*15.09*	*17.21*	*56.11*	*2.13*
Apache Corp	UNITED STATES	33,067	35,021	2.36	3.15	6.36	1.53	1.49	*26.97*	*25.05*	*25.49*	*75.01*	*3.03*
Marathon Oil Corp	UNITED STATES	26,444	32,969	0.36	3.12	5.88	1.08	1.06	*18.98*	*13.15*	*18.46*	*11.41*	*1.82*
Hess Corp	UNITED STATES	24,761	27,786	0.61	3.28	7.57	1.72	1.60	*25.92*	*10.71*	*20.02*	*18.67*	*1.85*
Anadarko Petroleum Corp	UNITED STATES	21,016	31,720	2.28	3.47	8.59	1.10	1.06	*13.44*	*7.33*	*10.77*	*65.79*	*1.31*
Chesapeake Energy Corp	UNITED STATES	18,881	31,767	4.08	6.33	9.10	1.54	1.26	*16.33*	-	*7.48*	*64.47*	*1.00*
XTO Energy Inc	UNITED STATES	24,395	34,819	4.30	5.80	10.76	2.05	1.56	*19.79*	*14.58*	*16.58*	*74.15*	*1.97*
EOG Resources Inc	UNITED STATES	21,103	21,882	3.39	4.42	10.16	2.22	2.13	*24.54*	*18.67*	*26.53*	*76.78*	*3.33*
BG Group PLC	BRITAIN	60,655	60,136	2.57	4.99	10.13	2.76	2.80	*34.14*	*21.70*	*38.78*	*51.55*	*3.33*
Tullow Oil PLC	BRITAIN	9,163	9,168	6.27	8.64	25.76	6.14	6.12	*19.03*	*17.97*	*15.48*	*72.64*	*1.46*
Cairn Energy Plc	BRITAIN	4,847	5,037	13.28	25.21	51.15	2.73	2.56	*3.31*	*3.06*	*11.93*	*52.66*	*0.93*
Repsol YPF SA	SPAIN	35,314	45,586	0.51	3.34	7.29	1.01	1.01	*16.49*	*7.64*	*14.29*	*15.36*	*1.35*
Cia Espanola de Petroleos SA	SPAIN	26,359	27,396	0.79	12.99	30.46	2.86	2.67	*14.19*	*8.24*	*11.10*	*6.07*	*1.51*
OMV AG	AUSTRIA	12,641	16,938	0.44	2.65	4.20	0.77	0.82	*22.16*	*10.78*	*21.22*	*16.68*	*1.99*
EnCana Corp	CANADA	46,480	54,423	1.92	4.78	10.33	1.84	1.64	*21.87*	*7.18*	*15.23*	*40.16*	*1.34*
Suncor Energy Inc	CANADA	36,640	42,481	1.82	6.72	10.40	2.17	1.87	*26.04*	*11.32*	*24.23*	*27.02*	*1.89*
Imperial Oil Ltd	CANADA	36,593	35,534	1.27	5.98	10.75	3.16	3.38	*43.21*	*23.50*	*51.72*	*21.27*	*3.98*
Canadian Natural Resources Ltd	CANADA	33,666	44,498	3.41	5.33	10.24	2.02	1.62	*21.06*	*4.78*	*17.23*	*63.92*	*1.34*
Husky Energy Inc	CANADA	36,381	35,805	1.54	4.19	7.99	2.06	2.10	*33.06*	*23.90*	*30.24*	*36.67*	*2.57*
Neste Oil OYJ	FINLAND	5,241	6,374	0.28	4.56	6.95	1.12	1.09	*19.80*	*11.32*	*15.99*	*6.25*	*1.47*
Total Gabon	FRANCE	2,020	2,080	1.02	1.70	4.39	1.65	1.62	*59.45*	*22.74*	*61.91*	*59.61*	*6.45*
Hellenic Petroleum SA	GREECE	3,172	4,586	0.28	6.86	9.89	0.77	0.83	*9.62*	*5.70*	*6.54*	*4.02*	*0.83*
Dragon Oil Plc	IRELAND	1,706	941	1.00	1.21	3.45	1.10	1.19	*33.97*	*27.27*	*94.53*	*82.58*	*11.25*
Paz Oil Co Ltd	ISRAEL	1,354	2,872	0.86	10.61	9.56	1.81	1.27	*22.97*	*5.52*	-	*8.12*	*0.84*
Saras SpA	ITALY	4,013	4,231	0.30	4.36	8.75	1.33	1.31	*20.43*	*9.69*	*19.36*	*6.92*	*1.60*
INPEX CORP	JAPAN	20,075	18,211	1.37	1.86	10.44	1.48	1.56	*17.21*	*11.35*	*23.78*	*73.94*	*2.97*
New Zealand Refining Co Ltd/The	NEW ZEALAND	1,058	1,114	4.48	7.21	13.83	1.93	1.84	*18.83*	*16.25*	*17.99*	*62.13*	*1.80*
Awilco Offshore ASA	NORWAY	2,147	3,761	8.95	14.48	16.17	3.41	1.68	*22.96*	*6.30*	*10.30*	*61.83*	*1.10*
Galp Energia SGPS SA	PORTUGAL	13,794	15,547	0.69	10.81	20.24	3.29	2.62	*17.85*	*7.40*	*16.80*	*6.34*	*1.24*
Addax Petroleum Corp	SWITZERLAND	4,181	4,968	0.93	1.08	3.84	1.28	1.22	*45.06*	*14.31*	-	*86.20*	*1.24*
Woodside Petroleum Ltd	AUSTRALIA	28,305	30,312	5.61	7.65	13.35	3.96	3.31	*40.83*	*25.64*	*38.31*	*73.34*	*3.20*
Developed markets weighted average		12,913	15,185	0.85	4.24	8.31	1.59	1.46	*25.64*	*15.45*	*23.73*	*46.68*	*2.29*
Developing markets													
YPF SA	ARGENTINA	18,644	18,689	2.00	5.39	14.21	2.62	2.61	*16.21*	*11.12*	-	*37.09*	*1.21*
Petroleo Brasileiro SA	BRAZIL	167,629	192,953	1.80	5.55	10.13	2.64	2.17	*25.74*	*13.84*	*29.23*	*32.45*	*1.80*
PetroChina Co Ltd	CHINA	326,649	327,023	2.05	8.69	16.83	10.16	10.06	*17.33*	*12.98*	*184.21*	*23.62*	*13.39*
China Petroleum & Chemical Corp	CHINA	122,546	154,123	0.66	13.17	23.53	8.76	3.38	*10.71*	*4.30*	*13.31*	*5.01*	*1.20*
Ecopetrol SA	COLOMBIA	47,696	48,001	2.63	5.56	9.42	3.41	5.19	*31.58*	*16.77*	*62.11*	*47.32*	*5.60*
INA Industrija Nafte DD	CROATIA	5,493	6,414	1.08	9.05	17.17	1.62	1.49	*10.30*	*6.67*	*7.86*	*11.89*	*0.92*
CNOOC Ltd	HONG KONG	50,875	46,462	2.28	4.32	7.06	1.74	1.87	*32.03*	*24.42*	*37.11*	*52.86*	*2.79*
MOL Hungarian Oil and Gas NyRt	HUNGARY	9,456	10,930	0.50	3.85	6.67	1.13	1.11	*25.65*	*10.40*	*13.26*	*12.98*	*1.04*
Oil & Natural Gas Corp Ltd	INDIA	47,084	40,272	1.55	3.78	8.54	1.88	2.22	*29.05*	*20.76*	*34.25*	*40.92*	*2.58*
Reliance Petroleum Ltd	INDIA	13,745	16,686	2.12	18.13	24.50	3.51	2.43	*22.02*	*9.15*	*10.60*	*11.68*	*0.76*
Indian Oil Corp Ltd	INDIA	10,320	18,748	0.30	7.05	8.01	0.85	0.91	*13.16*	*5.65*	*6.74*	*4.25*	*0.58*
KazMunaiGas Exploration Production	KAZAKHSTAN	7,501	7,594	1.24	1.97	3.47	1.00	1.40	*26.83*	*19.80*	*30.98*	*62.74*	*2.84*
Oil & Gas Development Co Ltd	PAKISTAN	5,196	5,068	2.53	3.49	5.92	2.10	2.16	*50.20*	*39.50*	-	*72.50*	-
Polskie Gornictwo Naftowe I Gazownictwo SA	POLAND	8,065	6,955	0.86	4.52	11.27	0.77	0.74	*7.79*	*6.04*	*8.89*	*19.06*	*0.61*
SNP Petrom SA	ROMANIA	6,845	5,853	1.08	4.21	7.78	0.95	0.94	*14.44*	*9.30*	*11.25*	*25.72*	*1.19*
Slovnaft AS	SLOVAKIA	3,395	3,328	0.72	6.81	11.05	1.37	1.38	*14.93*	*10.84*	-	*10.54*	*1.18*
Sasol Ltd	SOUTH AFRICA	28,505	30,269	1.71	4.69	7.77	2.20	2.06	*37.35*	*18.57*	*35.90*	*36.34*	*2.06*
PTT PCL	THAILAND	19,005	23,861	0.44	4.61	6.46	1.26	1.20	*24.29*	*10.63*	*17.18*	*9.61*	*0.98*
PTT Exploration & Production PCL	THAILAND	12,396	12,358	3.02	4.15	9.51	2.48	2.49	*35.24*	*20.65*	*38.26*	*72.81*	*1.98*
Ukrnafta Oil Co	UKRAINE	1,228	1,203	0.67	1.84	3.47	0.58	0.57	*10.49*	*15.00*	*21.05*	*36.54*	*2.03*
Developing markets weighted average		21,121	23,842	1.04	6.45	11.50	2.80	2.51	*21.20*	*13.01*	*81.85*	*27.27*	*5.84*
Russia													
Gazprom OAO	RUSSIA	174,774	215,748	1.73	3.80	4.98	0.90	0.91	*18.72*	*10.96*	*17.61*	*45.43*	*1.45*
Rosneft Oil Co	RUSSIA	68,888	91,217	1.22	4.59	6.22	1.40	1.27	*29.95*	*13.00*	*11.22*	*26.59*	*1.15*
LUKOIL	RUSSIA	48,822	54,672	0.47	2.58	3.54	0.78	0.80	*25.65*	*17.73*	*25.25*	*18.34*	*2.02*
Surgutneftegaz	RUSSIA	17,744	10,636	0.40	1.12	3.40	0.42	0.30	*11.36*	*21.17*	*17.02*	*35.45*	*1.11*
TNK-BP Holding	RUSSIA	23,374	26,011	0.57	2.12	2.85	0.98	0.99	*39.89*	*19.80*	*49.97*	*27.06*	*5.53*
Gazpromneft OAO	RUSSIA	22,237	21,818	0.72	2.63	3.78	1.37	1.38	*39.32*	*28.73*	*40.21*	*27.41*	*3.90*
NovaTek OAO	RUSSIA	15,789	16,300	4.55	9.19	13.30	3.11	2.92	*27.88*	*21.79*	*29.28*	*49.51*	*2.66*
Tatneft	RUSSIA	8,279	7,806	0.40	2.09	3.52	0.69	0.67	*19.15*	*13.03*	*24.69*	*19.00*	*2.22*
Bashneft	RUSSIA	1,909	1,473	0.29	1.27	2.59	0.50	0.43	*19.35*	*17.42*	*24.58*	*23.08*	*2.06*
Ritek OOO	RUSSIA	600	1,025	1.20	6.10	6.25	0.83	0.98	*20.86*	*11.26*	-	*19.66*	*1.57*
AK Transneft OAO	RUSSIA	4,416	11,295	1.14	2.05	1.69	0.53	0.74	*14.42*	*8.83*	*23.51*	*55.45*	*1.75*
Russia weithed average		17,343	20,542	0.98	3.25	4.49	0.92	0.93	*21.01*	*12.76*	*18.23*	*30.14*	*1.58*

Source: company's data, Bloomberg; Estimation: Veles Capital

Effectiveness and ratability ratio of Transneft's assets versus other companies



Source: Bloomberg, Estimation: Veles Capital

Fair price estimation (comparable approach)

Capitalization, mn USD

	Current price	Growth potential, %	Fair price	EV/S	EV/EBITDA	P/E	P/BV	EV/IC
Gazprom OAO	174,774	*29*	224,651	36,355	114,006	218,054	302,934	313,389
LUKOIL	48,822	*63*	79,515	52,297	64,588	80,612	91,994	89,488
Rosneft Oil Co	68,888	*4*	71,534	17,090	38,549	109,014	72,369	86,129
Surgutneftegaz	17,744	*186*	50,737	27,475	50,799	29,368	70,348	59,623
Gazpromneft OAO	22,237	*5*	23,326	15,758	24,141	35,113	19,497	19,999
TNK-BP Holding	23,374	*45*	33,906	21,278	38,755	48,583	29,435	28,078
NovaTek OAO	15,789	*-62*	6,007	2,024	5,142	6,209	7,363	6,874
Tatneft	8,279	*87*	15,503	12,805	13,651	14,341	18,380	16,495
Bashneft	1,909	*154*	4,848	3,725	4,252	4,357	5,881	5,258
Ritek OOO	600	*58*	951	267	348	980	1,182	1,407
AK Transneft OAO	4,416	*75*	7,707	-1,817	7,082	9,964	5,456	9,218
Growth potential of secor		*34.95*						

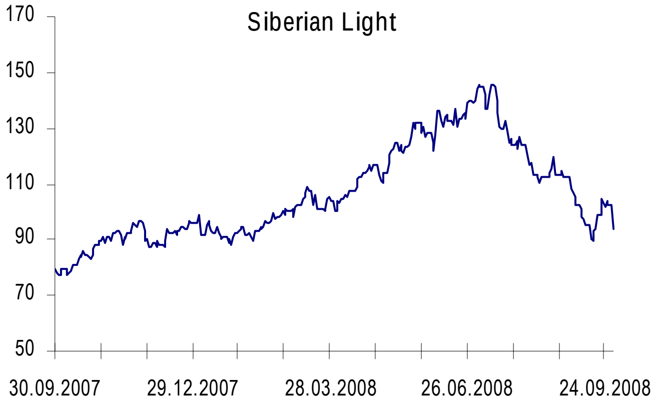
Source: companies' data, Bloomberg, Estimation: Veles Capital

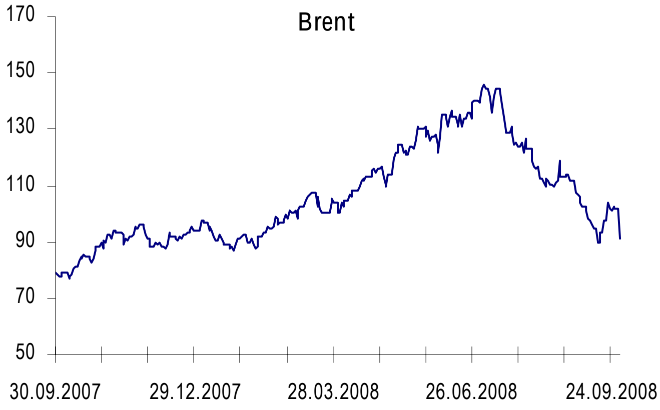
Commodity markets

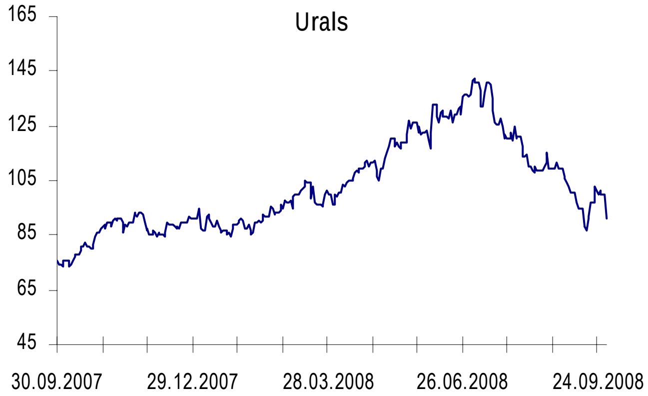
Current oil prices

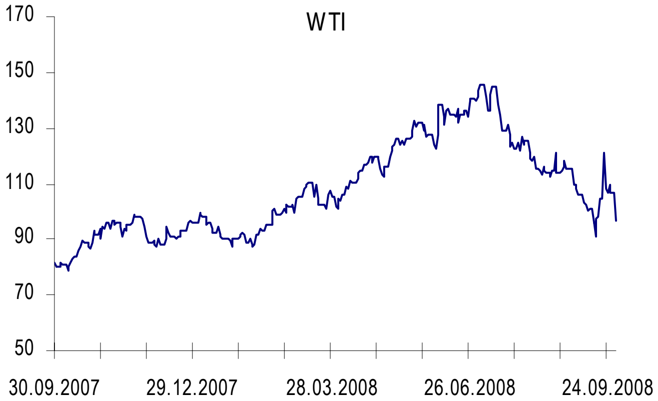
		Close, USD	Change, USD	Change, % *day*	*week*	*month*	*from Jan 1*	*year*	Current year, USD min	max
Light, USD / bbl	▼	93,53	-9,04	-8,81	-10,74	-16,73	-2,47	17,62	-0,74	147,59
Brent, USD / bbl	▼	91,17	-10,86	-10,64	-12,43	-18,58	-2,90	14,82	85,05	147,21
Urals, USD / bbl	▼	91,15	-9,04	-9,02	-11,24	-16,74	-0,14	20,35	-3,32	142,94
WTI, USD / bbl	▼	96,37	-10,52	-9,84	-20,30	-16,53	0,39	18,01	86,47	146,30
Brent-Urals	▼	0,02	-1,82	-98,91	-98,59	-99,20	-99,23	-99,45	-2,01	9,94

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 thee 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 united object cost evaluation*	*Shareholders' capital value calcculation (**SV**)*
DCF method (FCFF)	$EV = \sum_{i=1}^{n} \frac{FCFF_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_i)^n} + NA$	$SV = EV - D$
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	$EV = IC_1 + \sum_{i=1}^{n} \frac{EVA_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_i)^n} + NA$	$SV = EV - D$
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*

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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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