



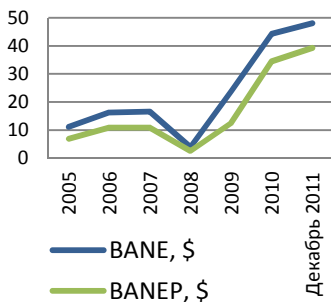
BASHNEFT

Analysts – Oil & Gas

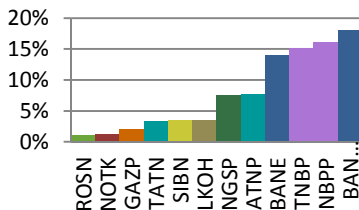
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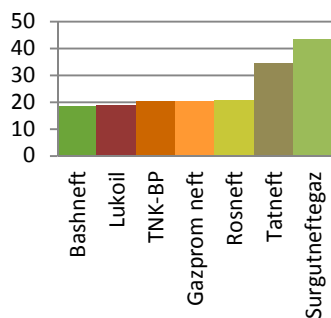
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Dividend Yield, 2010



Reserve life, years



Investcafe begins coverage of Bashneft, an oil company with the main resource base in the Republic of Bashkortostan. The current quotes for the company's shares do not fully price in its development prospects. Our rating on Bashneft common and preferred shares is **BUY**. The year-end 2012 target prices for Bashneft are **USD 68.71** per common share and **USD 54.97** per pref.

Before falling under control of AFK Sistema in 2009, companies in the Bashkir fuel and energy sector were fragmented, inefficient, and non-transparent. Once these companies were integrated, Bashneft began publishing financial statements according to IFRS, demonstrating outstanding performance from year to year. AFK Sistema is an efficient owner, which has assigned itself the task of establishing a transparent and cost-effective vertically integrated oil company around Bashneft, and has so far been successful in the pursuit of this goal. Financial reports from the company show staggering rates of revenue growth and widening profit margins.

The Republic of Bashkortostan is a key production area for Bashneft, where the company produces about 94% of its oil. Oil from the company's Bashkir fields leaves much to be desired in quality terms, though, as it has a large sulfur content. In addition, Bashneft's recoverable reserves are not easy to extract. Nearly half (48%) of the company's recoverable reserves are hard to recover, while the remaining recoverable reserves have a high degree of depletion (of more than 80%) and water cut (above 90%), which entitles Bashneft to concessions on mineral extraction tax (MET, the effective MET rate stood at 78% of the full rate in 2010).

Current oil production volumes allow the group to utilize only about 60% of its available capacity. Given this, the priority task for Bashneft is the development of its production segment through the exploration of new oil fields and organic production growth. For the next 7 years, Bashneft aims to bring oil production up to 18 mn tons per year, along with the scheduled production on the Trebs and Titov oilfield, located in the Nenets Autonomous Region. The company will still not be able to completely load its available refining capacity using in-house crude. Given the surplus of refining capacity, the company will lose from the imposition of the new taxation regime (EBITDA is to decline by 5% in 2012 vs prior estimates). For the five next years, Bashneft will receive a RUB 10 mn compensation annually for the imposition of the 60-66-90 tax regime. The company had requested twice as large amount as compensation for the same period. The company will continue to increase the refining depth at its oil refineries, which should partially offset the negative effect from the imposition of the new tax regime.

Given the need to invest in capital expenditures, management and shareholders are likely to agree on dividend cuts. For this reason, we expect a lower, although still high, percentage of net income to be earmarked for dividends in the subsequent periods, estimated to remain under 95%.

Our **BUY** recommendation was derived from a 10-year DCF model. Target price on common shares is **USD68.71** and **USD54.97** for the preference shares, with the growth potential of **43%** and **40%** respectively.

Bashneft shares, BANE and BANEP

Target price (commons)	USD	68.71
Upside potential (commons)	%	43%
Number of common shares	mn	170,2
Free Float (commons)	%	14%
Target price (prefs)	USD	54.97
Upside potential (prefs)	%	40%
Free Float (prefs)	%	100%
Number of preferred shares	mn	34,6
Market capitalization	USD mn	9,527
Enterprise Value	USD mn	12,373

Source: MICEX, Bashneft data,
Investcafe estimates

Financial and market ratios

	2010	2011E	2012E	2013E
Revenue (USD mn)	13,341	16,657	15,278	16,898
EBITDA (USD mn)	3,015	3,813	2,183	2,291
Net income (USD mn)	1,429	1,818	556	556
EBITDA margin (%)	23%	23%	14%	14%
Net margin (%)	11%	11%	4%	3%
EPS (USD)	8.40	10.68	3.27	3.26
DPS (commons and prefs) (USD)	7.7	8.4	2.6	2.6
P/E (x)	5.27	4.49	14.68	14.70
EV/S (x)	0.87	0.64	0.83	0.76
EV/EBITDA (x)	3.84	2.81	5.80	5.61
ROE (%)	27.1%	33.6%	12.9%	12.7%
Urals oil price (USD/bbl)	78	110	105	110

Source: MICEX, Bashneft data, Investcafe estimates

