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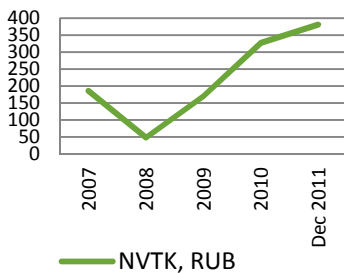
NOVATEK

Analysts – Oil & Gas

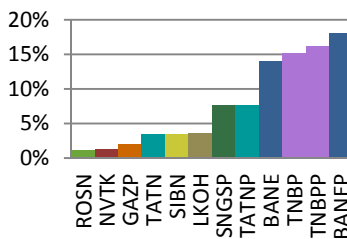
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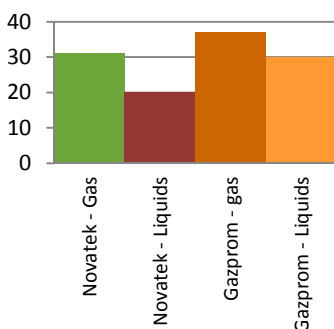
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Dividend Yield, 2010



Reserve Life, years



With this research we are initiating coverage of Novatek, Russia's biggest independent gas producer. The company's shares are fairly valued by the market. As a result, we place a **BUY** rating on Novatek shares and a target price of **RUB 487.02** per share.

Novatek is Russia's single largest independent gas producer and Russia's second largest gas producer after Gazprom. In 2010 production reached 37.2 bcm of natural gas and 3.6 mln t of liquids. According to our forecast production of natural gas will double by 2020.

With the arrival of Gennady Timchenko, the company has begun to demonstrate remarkable growth rates and taken the lead in the Russian oil and gas sector in profitability terms. Despite the existing legal restrictions in the gas industry imposed on independent gas producers, lobbying power of the main shareholder promises Novatek good prospects in terms of new acquisitions from the Russian Subsoil Agency pool, taxation benefits on their development and easy access to Gazprom's pipelines for distribution, all of which should allow Novatek to compete with Gazprom for a larger share of the domestic market.

Novatek's strategy focused is on developing its core gas production business in Russia through organic production growth at existing fields as well as acquisitions. Novatek has substantial proved resources and about 31 years of reserve life for natural gas and 20 years of reserve life for liquids at current levels of production. Yamalo-Nenets Autonomous Region in Western Siberia, where the company produces 100% of its gas will remain key to the company achieving its long-term plans. The production growth in 2011 will be mainly achieved through the development of the Yurkharovskoye field, the company's largest to date. However, the production growth will continue, perhaps not as rapidly as in the recent past, until the development of the South-Tambeyskoye gas field gets underway. Company's more distant plan calls for the implementation of a major project to develop another large field, the Yuzhno-Tambeyskoye, and build the Yamal LNG liquefied gas plant. We see the launch of the plant, which will liquefy gas from this field, happening in 2016.

In furthering the Yamal LNG project, Novatek has achieved what nobody else previously had managed to do: the company has reached an agency contract with Gazprom on gas exports, which gives the company the right to export gas through Gazprom's mediation. In addition, the gas intended for liquefaction will qualify for a tax break in the form of a zero mineral extraction tax rate starting in 2012. This will ease the tax burden on the company while the MET indexation will be taking place during significant production growth that will follow the launch of production at Yuzhno-Tambeyskoye.

Novatek demonstrates outstanding financial results from year to year by expanding gas production, cashing in on rising domestic gas prices and checking growth in controllable expenses. Novatek boasts the best profitability ratios among Russian oil companies. We forecast this trend to continue and Novatek to remain impressively profitable. EBITDA margin is to grow from 49% in 2010 to 55% in 2020.

Backing up our assumptions with estimates and calculations, we assign Novatek shares a **BUY** rating and a target price of **RUB 487.02** per ordinary share. Upside potential based on current (26/12/11) share price is at 27.8%.

Ordinary company shares (NVTK)

Target price	RUB	487.02
Current price	RUB	380.91
Upside potential	%	27.8
No. of shares	mln	3,036
Free Float	%	30
Market capitalisation	bln RUB	1,157
Enterprise Value	bln RUB	1,219

Source: MICEX, company data, Investcafe estimates

Financial and market indicators

	2010	2011E	2012E	2013E
Revenue (mln RUB)	115,162	176,579	198,343	241,852
EBITDA (mln RUB)	57,537	82,274	93,174	122,876
Net Income (mln RUB)	40,533	56,927	64,618	86,455
EBITDA margin (%)	49%	46%	46%	50%
Net margin (%)	35%	32%	32%	35%
EPS (RUB)	13.3	18.7	21.3	28.5
DPS (RUB)	4.00	5.90	7.02	9.81
P/E (x)	25.0	20.3	17.9	13.4
EV/S (x)	9.3	7.0	6.2	5.0
EV/EBITDA (x)	18.7	15.0	13.2	9.9
ROE (%)	24%	27%	25%	27%
Urals (\$/bbl)	81	110	105	110
Free Cash Flow (mln RUB)	50,465	(14,652)	47,547	62,415

Source: MICEX, company data, Investcafe estimates

