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Russian Oil & Gas

Governance, growth, and risk – Why Russian oil & gas is cheap, and how things are improving this year

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Investor concerns of poor corporate governance, high political risk, and growth constraints in the Russian oil & gas sector are legitimate, but more than priced in, we think. Indeed, we see significant progress being made on several fronts that investors may not fully appreciate, including 3 key regulatory advances expected this autumn. We boost Gazprom's 2013E exports to 155bcm, reiterating it and SurgutNG prefs as our two Best Ideas in Russian oil & gas.

- **Governance, growth, and risk – Why Russian oil & gas companies are cheap:** We see the 3 key reasons why Russian oil & gas stocks trade on such low multiples: 1) Poor corporate governance: poor reinvestment of cash, indifference to minorities, misaligned incentives between minorities and controlling shareholders, etc; 2) High perceived political risk: Seemingly unstable/arbitrary tax, tariff, and regulatory regimes; and 3) Growth constraints: Mature assets/high decline rates, a tax regime highly geared to oil prices, weak European gas demand, etc.

- **Autumn's 3+1+1 policy blitz should help:** Substantial work since 2012 should culminate in 2H13 with 3 new bills that significantly reduce risk and growth issues: 1) A new offshore tax regime (growth for ROSN); 2) a new gas tax regime (growth boost, political risk reduction); and 3) LNG export liberalization (growth for ROSN, NVTK) should all be approved by year-end. Add in a tight oil tax break recently signed into law (growth for all oil producers), and a material increase in Gazprom dividends (governance improvement) that is likely coming, and we think the autumn is shaping up to be a good one for Russian oil & gas. The fly in the ointment? A likely halt in gas tariff increases for 2014 (negative for Novatek, Gazprom).

- **Best Ideas remain GAZP and SNGSp:** GAZP's re-rating should be extended if: i) European exports continue to rise – we boost 2013E exports to 155bcm (growth); ii) a Chinese deal is reached (growth); and/or iii) the government boosts dividends again (governance). SNGSp remains one of our favorite defensive stocks (trades at parity with cash), with its 40% payout (governance) and 11.5% forecast yield. We continue to like Bashneft after our upgrade as the board moves to resume generous dividends and eliminate circular ownership via Sistema-Invest (large governance improvement), and the launch of the Trebs & Titov project (growth).

- **The others:** Both NVTK and ROSN have substantial growth prospects not captured in near-term multiples, in our view, and we see medium-term upside potential. We see Lukoil as undeniably cheap, but with few near-term catalysts.

- **Revised long-term oil price assumption drives TP changes:** We raise our long-term oil price assumption from $80/bbl nominal to $90/bbl real. This boosts our DCF valuations by 5% to 20% but our target prices rise more modestly and we make only one change in our recommendations (Alliance Oil moves to 2H from 2), as higher TPs only confirm our existing view that the Russian oil & gas space is oversold.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Data Summary

		Rating		Target Price		Current Year Earnings Estimates	
Company	**Ticker**	**Old**	**New**	**Old**	**New**	**Old**	**New**
Alliance Oil	AOILsdb.ST	2	2H	SKr62.70	SKr60.20	US$1.64	US$0.70
Bashneft	BANE.MM	1	1	US$74.20	US$79.20	US$9.77	US$9.77
Gazprom	GAZP.MM	1	1	US$7.00	US$7.50	US$1.34	US$1.35
Lukoil	LKOH.MM	1	1	US$81.00	US$88.00	US$14.58	US$14.31
Novatek	NVTKq.L	1	1	US$163.00	US$163.00	US$9.63	US$9.31
Rosneft	ROSN.MM	1	1	US$9.20	US$10.00	US$1.26	US$1.14
Gazpromneft	SIBN.MM	1	1	US$5.77	US$6.31	US$0.92	US$0.99
Surgutneftegaz	SNGS.MM	1	1	US$1.17	US$1.24	US$0.23	US$0.24
Surgutneftegaz(pref)	SNGS_P.MM	1	1	US$1.11	US$1.18	US$0.24	US$0.24
Tatneft	TATN.MM	2	2	-	-	US$1.02	US$0.95
Tatneft(pref)	TATN_p.MM	2	2	-	-	US$0.95	US$0.95

Contents

Investment case: Why Russian oil & gas is (too) cheap

The Russian oil & gas sphere has been largely out of favor with investors over the past several years, to the point that valuations are thoroughly beaten up for most all of the main players. Why are Russian oil & gas companies so cheap? We put it down to a combination of investor worries about poor corporate governance, political risk, and growth constraints. While none of these points will surprise seasoned Russian investors, we think substantial progress is being overlooked by the market. In particular, 4 key policy advances – one recently finalized – are highly likely to be achieved by year-end. A fifth – a material increase in Gazprom's dividends, which would have sentiment effects beyond Gazprom itself – could be confirmed by the end of the year as well, albeit with less certainty than the others.

Poor corporate governance, growth constraints, and political risk

The average Russian oil & gas company is trading at 3.9x EV/EBITDA and 8.5x P/E (Figure 9). Among the blue chips, Gazprom and Lukoil are trading at 2.4x-2.8x on EV/EBITDA and 3.3x-4.3x on P/E, levels that imply that the market has serious issues with those companies on risk or growth.

Consistent with that, the main reasons given to us by investors for the low valuations typically – and logically – circle around 3 common themes:

Why are Russian oil & gas companies cheap? Poor corporate governance, growth constraints, and political risk

- **Poor corporate governance:** The most-cited issues here are: 1) perceived poor reinvestment of cash flows; 2) misaligned incentives between management and/or controlling shareholders on the one hand and minority shareholders on the other; and 3) management indifference to the concerns of minorities.

- **Growth constraints:** Russia's mature oil companies – Lukoil comes to mind – face the typical problems of natural decline rates and the large base effect, while Gazprom's problems are on the marketing side rather than production (i.e., it could produce much more gas if it could just find a customer linked to its pipeline system). We think it no accident that Novatek and Rosneft – the two blue chip companies with the best growth opportunities – are also the two companies that trade at the highs near-term multiples (Figure 9).

- **Political risk:** This particularly relates to unstable taxation and seemingly arbitrary tariff regimes, with the government seemingly constantly mooting one change or another to both. In reality, the oil tax regime has been remarkably stable in retrospect, although it has evolved with a tweak to coefficients being made every 2-3 years, but the chatter coming from the various ministries on the need to change this or that part of the tax code has made it seem less stable than it has been in practice.

Novatek proves the rule

Novatek is best-in-class on all 3 points

Note that Novatek, is perceived well on all three counts, and has been rewarded by the market with high multiples over the years, and currently trades at 8.7x EV/EBITDA and 14.0x P/E on our 2013 forecasted numbers.

1) Corporate governance: Novatek's main shareholders, particularly founder and CEO Leonid Michelson, have consistently communicated over the years their close interest in the company's share price, indicating that their interests are aligned with minorities'. Additionally, the company's high returns on invested capital (ROEs over the past 6 years have averaged 30%, while ROCEs have averaged 29%) likely give investors comfort that cash not paid out as dividends will be reinvested into the business at high returns.

2) Growth: Novatek has exhibited a torrid growth profile, driven partly by rising domestic gas tariffs (a theme that is fading, however), and partly by ever-increasing production numbers. Gas production growth has averaged a 12% CAGR over the last 6 years, while liquids production has increased at an 11% CAGR. Going forward our own numbers see production growing at c7-8% compounded rates before even considering the impact of Yamal LNG.

3) Political risk: Mr. Michelson has always seemed adept at steering the company through Russia's political waters. His early successes were especially impressive, given Gazprom's seeming chokehold on the gas market when Novatek came to market in the middle of the last decade. In 2009 Novatek's perceived political risk was further reduced[1] when Gennady Timchenko – reportedly a close friend of Russian President Vladimir Putin and founder and owner of Gunvor, one of the world's largest oil traders – emerged as a key shareholder of Novatek.

Is Russia improving on these points? Yes, we think

It is beyond the scope of this note to fully address all three of these issues here, but we would note the following:

Political risk – Things are actually improving

- **Political risk – Things are actually improving:** One way to define risk is volatility. In that light, an argument can be made that the political risk for the Russian oil & gas sector is relatively high, as the government seems to be constantly proposing one change or another to Russia's oil and gas tax regimes and tariff policies.

  However, while the volatility has been real – at least judging from the number of times bureaucrats are quoted in the press about the need to adjust this tax regime or that tariff policy – as it turns out most of the changes we have seen actually proposed since the 2012 election are breaking *in favor* of the oil & gas companies, addressing a number of their long-standing issues.

  To wit:

  1) The new offshore tax regime should be signed into law this autumn, having just been approved by the Duma, replacing the existing one-size-fits-all onshore regime, which simply does not work in an offshore environment. This directly addresses growth issues, although admittedly it will mostly go to the benefit of Rosneft, which has the lion's share of offshore exploration licenses. Gazprom will benefit secondarily as the other traded state-owned oil & gas company (only state-owned companies have legal access to Russia's continental shelf), while Lukoil's promised breaks for its Caspian ventures are being swept up into this bill, as well (however, Lukoil and other non-state-owned companies are still being denied access to the continental shelf itself).

  2) The new gas tax law, also to be passed by year-end, will substantially de-risk new field development and reduce the uncertainty around gas producers' long-term earnings capacity in a given price environment. In doing so, this new law significantly reduces political risk in the gas business, as gas taxation prior to this has been arbitrary and unpredictable, lacking any sort of coherent theoretical framework and being determined year-to-year behind closed doors. Going forward the government's ability to

[1] or "growth expectations were boosted by" – take your pick

unexpectedly raise taxation will be severely constrained, reducing the earnings uncertainty for Russia's gas companies. Secondarily, growth prospects are improved somewhat, as the law very specifically decreases uncertainty for – and provides specific breaks for – new gas field development.

3) LNG liberalization should happen by year-end as well and, although a small negative for Gazprom, it improves growth opportunities for Novatek (especially) and Rosneft, giving those two companies options for developing significant, as-yet-untapped dry gas assets (Novatek and Yamal LNG, Rosneft and ExxonMobil with Sakhalin-1) or anticipated gas discoveries (Rosneft's multitudinous offshore licenses will likely contain large amounts of gas, especially in the Kara Sea, which is anticipated by the company to yield c55% gas).

4) The tight oil tax break law, already passed and signed into law in late summer, boosts growth opportunities by addressing at least some of the shortcomings of the existing system when it comes to the economics of low-permeability plays. Including the Bazhenov shale and the Achimov and Yurksky conventional plays, among others, this law opens up new opportunities for Russian oil companies under their existing license and infrastructure bases. While it's too early to say that tight oil will lead to outright oil production growth as it has in the US, at the least we think this law will allow Russian oil companies to offset some declines.

Note that we have written about tax and policy risk extensively in the past (Policy Risk In Oil & Gas Is Real — Looking For Signposts: February 9, 2012; Downgrade on Tax Threat – Policy Risk Is Indeed Real: March 20, 2012; (GAZP) The taxman cometh, and he wants 80-100%: March 16, 2012; Lukoil (LKOH.MM) - Raising TP on Passing Regulatory Risk, Maintain Buy: October 29, 2012; Gazprom dividends set to rise, government "takes decision" to raise payout to 25% of IFRS))*

Growth opportunities opened up by all 4 legal initiatives, while resilient oil prices limit downside risk

- **Growth opportunities opened up by all 4 of those legal initiatives:** The new offshore regime, the gas tax law, the tight oil tax breaks, and LNG liberalization all give Russian oil & gas companies access to better growth opportunities, each in their own way, and not equally for all companies, but there's something here for everyone.

Better dividends directly address poor corporate governance

- **Better dividends directly address poor corporate governance:** Until 2011, Russian oil & gas companies by and large did not pay dividends of any material magnitude, with yields for the sector generally ranging from 1%-2%. With its 15%-20% payout ratio, Lukoil for years was the gold standard in the sector.

  Since 2011, however, dividend policy across the industry has improved substantially. Gazprom has headlined the change, moving from a pittance of a dividend to its current 25% of RAS policy, the equivalent of c17.5% of IFRS net income. Dividend yields in the Russian oil & gas sector, when weighted for market capitalization, now average 4.5%.

  Higher dividends directly address several corporate governance concerns. First, by returning cash immediately to shareholders, higher dividends reduce the cash available to be spent poorly by management. Second, the higher the dividends, the more aligned the interests of controlling and minority shareholders become.

  We think dividends are still rising: The government appears committed to its goal of moving all state-owned companies to 25% of IFRS, which for Gazprom alone

implies a further c40% hike in payout, and private companies such as Lukoil, we think, will be forced to improve payouts to match. Recent newsflow indicates the government may have taken a definitive decision to move Gazprom to that IFRS standard for its next dividend.[2]

In conclusion, while investors' concerns about the Russian oil & gas universe are hardly baseless, we think the pendulum has swung too far, past healthy skepticism to unwarranted pessimism. With improvement evident, we think a re-rating of the Russian oil & gas sector may be in the offing.

On this backdrop, why Gazprom and SurgutNG?

Why are Gazprom and SurgutNG Best Ideas when the subject is corporate governance, growth, and political risk?...

Although both Gazprom and SurgutNG have undeniable issues on all three issues – indeed, they are the poster children on several points – we think the market has overdone it. In particular, we think the market has overlooked either unarguable strengths (SurgutNG pref's guaranteed 40% payout ratio, for example) or substantial improvements, both those already made (Gazprom's seas change in dividends in 2011/12) and those we see upcoming (new gas tax law, further dividend increases for Gazprom).

- **Corporate governance improved by rising dividends:** Gazprom dividends have already gone through a sea change with little impact on the share price. More is coming, we are convinced, and potentially very soon. On September 9th local press reports indicated that the government has taken the final political decision to move the company to a 25% of IFRS net income policy, an effective 40% increase on the current policy (Gazprom dividends set to rise, government "takes decision" to raise payout to 25% of IFRS). As the key market criticism of Gazprom is poor reinvestment of retained earnings, increasing dividends should have a direct read-across to the stock price.

…because of visible improvements in growth and corporate governance

- **Growth projects gaining weight vs. maintenance CAPEX:** Gazprom's investments are moving from an era of big maintenance projects to more growth-oriented projects. It is beyond the scope of this note to delve into this deeply, but in brief:

  We estimate that c50% of Gazprom's gas-oriented CAPEX – maybe $15bn per year – has been going directly into a) the Yamal peninsula – including the development of the 4.9tcm Bovanenko field and the associated pipelines to bring that gas down to the distribution hub at Torzhok to the NE of Moscow; b) the expansion of onshore capacity to Vyborg from Gryazovets to enable Gazprom to deliver gas to the jump-off point of the Nord Stream pipeline; and c) development of major and secondary fields in the company's traditional Nadym-Pur-Taz region. All of these, we think, can be classified as a form of maintenance CAPEX, as its primary purpose is to allow Gazprom to continue to meet its existing export and domestic obligations for the upcoming decades. It is also mostly a one-off, particularly the investments into pipelines but also the initial development of the Bovanenko field.

  Going forward, we see CAPEX moving from what are effectively maintenance projects into growth-oriented projects, generally targeting Asia. In particular, this would be the Vladivostok LNG project (maybe $10bn-$15bn over 5 years, depending upon configuration), the Baltic LNG project (perhaps $7-$8bn), and Chinese exports via the so-called Eastern Route (up to $60bn, again depending upon configuration). All of these numbers are rough estimates, but indicate that

[2] In 2014 on 2013 financial results

Gazprom may spend c$80bn over the next 5-7 years – an annual amount similar that spent on what we identified as largely maintenance projects in the previous paragraph – on projects that are unambiguously growth-oriented.

- **Growth – No material impairment of European franchise forthcoming:** Gazprom's stock price, we think, has been pricing in not just a low or no-growth scenario, but a negative-growth future for the company. We think that, beginning in 2009, investors became particularly worried that the company's core earnings driver – its European export franchise – would be severely impaired by the LNG glut, weak European gas demand, and the general knock-on effects of the US shale gas revolution. Instead, with exports booming to the region and non-Russian gas supply alternatives falling, Gazprom's pricing and volumes to the region look solid in spite of tepid gas demand dynamics in the region.

- **Corporate governance:** SurgutNG prefs have a guaranteed, best-in-class dividend policy of 40% of pro-rata earnings, which elevates its corporate governance score far above what one might expect for the company (note that this does NOT apply to SurgutNG's common share, where all the worries about management's attitude towards minority investors, reflexive secrecy, and the issue of the former treasury shares all hold). For the preferred shares, however, we argue that cash flows are actually quite low-risk, with risk limited mostly to the effect of oil price and currency movements on net income.

The fly in the ointment – a tariff freeze for 2014E

- **Political risk, growth negative point – tariff increases likely to skip 2014:** It never happens that all things are going right at the same time. The fly in the ointment this autumn relates to political risk and growth for the gas companies, as it is increasingly apparent that the Russian government has taken the political decision to delay tariff increases for a year (Russian Oil & Gas - Natural monopoly tariff freeze now seems all but certain, effects larger for gas companies). A halt in price increases also carries the implication of a halt in gas transport tariff increases, a positive, partial offset for Novatek but negative for Gazprom.

  We zero out tariff growth for 2014E in our models, resuming 7.5% growth in 2015E. We likewise suspend our assumed 7% annual hikes in gas transport tariffs, helping Novatek (for which it is a cost) and impairing Gazprom (for which it is a revenue source) somewhat.

  Net-net, these changes reduce our 2014 net income estimates for Gazprom and Novatek by 3.7% and 3.1%, respectively. Because we project both tariffs to resume growing at our previously assumed levels of 7.5% (prices) and 7.0% (transport) thereafter, the reduced base has a knock-on effect through our normalized year, reducing out-year earnings for Gazprom by c7% and Novatek by c6%.

We see medium-term upside for Rosneft and Novatek

Divergence between DCF and multiple-based targets indicate that a fair amount of the advantages we see in NVTK and ROSN on corporate governance, political risk, and growth are already in the price. While we like both stocks, thinking that they should be part of an overweight position in Russian oil & gas, we prefer SNGSp and GAZP on a relative basis over the next 6-12 months.

Novatek – Tariff slowdown takes some wind out of the sails

Novatek and Rosneft have value not captured by near-term multiples, but catalysts may be a bit over the horizon

The recent threat to zero-out gas tariff growth for 2014 is a particular risk for Novatek, as that company has the most exposure to domestic gas prices in our universe. At points in the company's history, forecast tariff growth has been responsible for as much as 60% of our forecast earnings growth. Although many of those increases came to pass, and although the government is nowhere near its netback parity goal for domestic gas prices, the sharp slowdown in Russian economic growth has taken the wind out of the sails for further domestic tariff increases.

Until recent days the subject of the debate had been whether tariffs should rise at 15% in 2014 – as officially planned – or at a 6-7% inflation rate. However, last week the tenor changed to whether gas prices should rise at that 6-7% inflation rate…or remain flat with zero y-o-y growth. As we describe above, it now appears that the government most likely will follow through on the tariff constraint for a single year.

All else being equal, the one-year hiatus in tariff increases of both types reduces our Gazprom DCF by 11% and our Novatek DCF by 8%. While negative for both companies, we see enough positive catalysts to keep Gazprom a Best Idea in spite of this setback.

Rosneft – A Buy, but catalysts back-loaded

Rosneft: We like it, but the key catalysts – the first test wells offshore – won't happen until 2014

Rosneft's relatively high multiples are justified by its superior growth prospects, in our view. However, neither of the company's two key sources of growth – its 46 offshore licenses (it dominates that frontier) and its large refinery upgrade program – will show up in results inside the next 12-18 months. The nearest clear-cut catalyst on this front that we can see would be the two test wells in the Kara and Black Seas Rosneft and ExxonMobil will be drilling next summer. If commercial amounts of hydrocarbons are found – something we consider quite likely at least in the Kara Sea – the market will likely be informed no earlier than late 2014, we think.

Therefore, while we rate Rosneft a Buy, and think it should figure prominently in any GEM portfolio, we are less confident in stock performance in the next 6-12 months, at least relative to Gazprom and SurgutNG prefs.

Lukoil – few visible catalysts

Lukoil: Upside, but has growth issues and few catalysts

We maintain Lukoil at a Buy, and see significant upside potential in the stock on a medium-term view. However, it is not one of our Best Ideas given that we struggle to see any company-specific catalysts over the upcoming 3 months (the time horizon of a Best Idea) that could re-rate the stock. In particular, Lukoil has issues with the 3 key Russian discount drivers introduced with this note, in particular growth, which will take time to be answered.

Lukoil is facing a problem typical for large, mature oil producers. Lacking Rosneft's large, young fields and huge portfolio of offshore licenses, Lukoil is scrambling to offset declines at ageing core fields. Progress has been made in recent years, with Lukoil stabilizing West Siberian and then winning the 1.4bn bbl Imilorskoye field last

year. Also, as an early adapter of US shale technology to West Siberian conventional plays, Lukoil may benefit from the new tight oil tax breaks. However, we think the market will be hesitant to credit the company with anything more than stagnant production levels until proven wrong.

On corporate governance, we think the market is still waiting for Lukoil to move to its long-promised 30% or 40% dividend payout, although we give management positive marks for finally breaking out of a decade-long 15-20% range with its latest, c22%, payout.

Bashneft – Big improvement in governance

Bashneft is rapidly improving its corporate governance with a return to high dividends and elimination of circular shareholdings

Our investment thesis for Bashneft remains intact, and we maintain our Buy rating on the stock. For more details, see our recent upgrade of the stock see (Bashneft (BANE.MM) - Upgrade to Buy as IPO preparation evident: Dividends rising, circular ownership to be eliminated, September 9). Bashneft's main growth driver will be the launch of the Trebs & Titov fields, where test production is already getting under way. However, the main driver recently has been rapidly-improving corporate governance, as it appears set to resume of generous dividends in 4Q13 and eliminate of the circular ownership via Sistema-Invest.

Gazpromneft – Growth ambitions

Gazpromneft scores unusually well on growth, with ambitious plans to raise production to 100mn toe (2mn boepd) by 2020 – 67% above 2012 levels. However, we feel the market is unlikely to give it full credit for its growth potential while the company is in running through the period of high CAPEX needed to underpin that growth. Peak CAPEX is likely to run through 2015. In keeping with informal government policy not yet reflected at the parent, Gazprom has Gazpromneft paying 25% of IFRS net income as dividends, a positive for governance.

Valuation, recommendation summaries

Below we show why we differentiate Rosneft and Novatek from the likes of Gazprom and Lukoil in terms of return indicators. ROSN and NVTK show significant upsides to their DCF (+45% including the offshore opportunity for Rosneft, +83%, for Novatek), but less compelling upsides to multiple-based targets (c-5% for Rosneft and +35% for Novatek, on average). Gazprom, by comparison, shows strong upsides on its long-term DCF and near-term multiples (+103% on DCF and 76% to 88% on multiples), while Buy-rated Lukoil shows a similar pattern (+58% on DCF, +20% to +31% on multiples).

Figure 1. Novatek target price derivation

	Prices, $/sh	Upside	Weight	Target multiple
Current price	$130			
DCF based TP	$189	83%	50%	
EV/EBITDA based TP	$141	36%	25%	11.4x
P/E based TP	$138	34%	25%	14.8x
Blended target price	**$163**	**59%**	**100%**	
Rating	**1-Buy**			

Source: DataCentral, Citi Research

Figure 2. Gazprom target price derivation

	Prices, $/sh	Upside	Weight	Target multiple
Current price	$4.4			
DCF based TP	$7.9	103%	50%	
EV/EBITDA based TP	$6.8	76%	25%	3.6x
P/E based TP	$7.3	88%	25%	5.4x
Blended target price	**$7.5**	**92%**	**100%**	
Rating	**1-Buy**			

Source: DataCentral, Citi Research

Figure 3. Rosneft target price derivation

	Prices, $/GDR	Upside	Weight	Target multiple
Current price	$8.0			
DCF based TP	$10.5	33%	50%	
EV/EBITDA-based TP	$8.1	1%	25%	5.1x
P/E-based TP	$7.0	-12%	25%	6.7x
Blended target price	**$9.0**	**14%**	**100%**	
+Offshore opportunity	$0.99	12%		
Total TP	**$10.0**	**26%**		
Rating	**1-Buy**			

Source: Citi Research

Figure 4. SurgutNG common, pref target price derivation

	Prices, $/GDR	Upside	Weight	Target multiple
Current price	$0.83			
DCF based TP	$1.24	57%	50%	
EV/EBITDA based TP	$1.12	41%	25%	0.5x
P/E based TP	$1.38	74%	25%	6.0x
Blended TP (comm)	**$1.24**	**57%**	**100%**	
Rating	**1-Buy**			
Current price, pref	$0.70			
Pref discount	5%			
Blended TP (pref)	**$1.18**	**77%**		
Rating	**1-Buy**			

Source: Citi Research

Figure 5. Lukoil target price derivation

	Prices, $/share	Upside	Weight	Target multiple
Current price	$62			
DCF based TP	$98	58%	50%	
EV/EBITDA based TP	$82	31%	25%	3.5x
P/E based TP	$75	20%	25%	5.2x
Blended target price	**$88**	**42%**	**100%**	
Rating	**1-Buy**			

Source: Citi Research

Figure 6. AOIL target price derivation

	Prices, $/GDR	Upside	Weight	Target multiple
Current price	48.5			
DCF based TP	74.7	57%	50%	
EV/EBITDA based TP	50.2	5%	25%	4.7x
P/E based TP	40.3	-15%	25%	5.8x
Blended TP	**60.2**	**26%**	**100%**	
Rating	**2-Neutral/ High Risk**			

Source: Citi Research

Figure 7. Gazpromneft target price derivation

	Prices, $/GDR	Upside	Weight	Target multiple
Current price	$4.39			
DCF based TP	$6.90	67%	50%	
EV/EBITDA based TP	$5.90	42%	25%	4.0x
P/E based TP	$5.54	34%	25%	5.6x
Blended target price	**$6.31**	**52%**	**100%**	
Rating	**1-Buy**			

Source: Citi Research

Figure 8. Bashneft target price derivation

	Prices, $/GDR	Upside	Weight	Target multiple
Current price	$59.0			
DCF based TP	$82.5	43%	50%	
EV/EBITDA based TP	$76.1	32%	25%	5.5x
P/E based TP	$75.9	32%	25%	8.5x
Blended target price	**$79.2**	**38%**	**100%**	
Rating	**1-Buy**			

Source: Citi Research

Figure 9. Russian oil & gas Comp Table

Company Name	Target Price	Rating	Price 09/14/13	Return to TP	Market Cap	P/E			EV /EBITDA			Div yield			Total Return
						2012A	2013E	2014E	2012A	2013E	2014E	2012A	2013E	2014E	
BG	14.2	Buy	12.0	18%	$65.1	14.9x	15.0x	12.8x	7.3x	7.1x	6.3x	1.4%	1.5%	1.6%	19%
Eni	17.8	Neutral	17.5	1%	$84.6	9.9x	13.9x	11.4x	2.9x	3.6x	3.4x	6.0%	6.2%	6.4%	8%
Repsol	20.0	Buy	18.5	8%	$32.1	12.1x	11.1x	13.5x	6.4x	4.6x	5.2x	5.1%	5.4%	5.7%	13%
RD Shell Class A	22.0	Neutral	20.7	6%	$211.7	8.1x	8.7x	8.8x	2.9x	3.2x	3.4x	5.2%	5.5%	5.6%	12%
Statoil	150.0	Neutral	135.2	11%	$72.7	8.0x	8.9x	8.4x	1.8x	2.2x	2.3x	5.1%	5.3%	5.4%	16%
Total	40.0	Neutral	42.8	-7%	$135.4	8.1x	8.6x	8.9x	2.8x	3.3x	3.4x	5.3%	5.5%	5.6%	-1%
Weighted average						**9.3x**	**10.2x**	**9.8x**	**3.4x**	**3.7x**	**3.7x**	**4.9%**	**5.1%**	**5.3%**	
Petrobras	17.5	Buy	15.1	16%	$101.2	8.9x	8.9x	9.5x	5.5x	5.8x	7.1x	3.2%	3.3%	3.1%	19%
Sinopec	7.6	Buy	6.1	25%	$91.1	9.1x	8.4x	8.1x	4.9x	4.8x	4.7x	6.1%	5.0%	5.2%	30%
Weighted average						**9.0x**	**8.7x**	**8.8x**	**5.2x**	**5.3x**	**5.9x**	**4.6%**	**4.1%**	**4.1%**	
Alliance Oil	60.2	Neutral-HR	48.5	24%	$1.3	3.5x	10.5x	5.2x	4.0x	4.6x	3.8x	0.0%	0.0%	0.0%	24%
Bashneft ord	79.2	Buy	59.0	34%	$9.3	6.5x	6.0x	6.9x	4.4x	4.2x	4.5x	1.3%	7.6%	6.1%	42%
Gazprom	7.5	Buy	4.38	71%	$100.6	2.8x	3.3x	3.9x	2.6x	2.8x	3.0x	4.4%	5.5%	4.3%	77%
Gazpromneft	6.31	Buy	4.39	44%	$20.8	3.6x	4.4x	4.4x	2.5x	2.6x	3.1x	6.8%	5.7%	5.0%	50%
Lukoil	88.0	Buy	61.8	42%	$47.9	4.2x	4.3x	5.2x	2.4x	2.4x	2.5x	3.9%	5.1%	5.0%	47%
Novatek	163	Buy	130.1	25%	$39.4	17.6x	14.0x	14.2x	11.8x	8.7x	8.2x	1.7%	2.1%	2.1%	27%
Rosneft	10.0	Buy	8.0	26%	$84.3	6.5x	6.9x	7.8x	5.0x	4.5x	5.3x	3.4%	3.6%	2.9%	29%
Surgutneftegaz ord	1.24	Buy	0.83	49%	$29.7	6.4x	3.5x	4.8x	0.5x	0.2x	nm	1.9%	2.6%	2.3%	52%
Tatneft ord		Neutral	6.8	n/a	$14.7	6.2x	7.1x	7.4x	4.8x	4.9x	4.8x	4.1%	3.5%	3.1%	n/a
TNK-BP Hld ord		Neutral	1.53	n/a	$22.9	2.6x	3.1x	3.5x	1.7x	1.4x	1.1x	9.2%	7.9%	7.0%	n/a
Surgutneftegaz (pref)	1.2	Buy	0.70	68%	$5.4	5.4x	3.0x	4.0x	0.4x	0.2x	n/m	6.8%	11.5%	9.0%	80%
Tatneft (pref)		Neutral	3.36	n/a	$0.5	3.1x	3.5x	3.7x	2.4x	2.5x	2.4x	8.2%	7.1%	6.3%	n/a
TNK-BP (pref)		Neutral	1.20	n/a	$0.5	2.1x	2.4x	2.7x	1.3x	1.1x	0.9x	11.7%	10.0%	8.9%	n/a
Weighted average						**5.9x**	**5.6x**	**6.3x**	**3.9x**	**3.5x**	**3.7x**	**4.0%**	**4.7%**	**4.0%**	
Total weighted average						**8.2x**	**8.5x**	**8.5x**	**3.9x**	**3.9x**	**4.1x**	**4.6%**	**4.8%**	**4.6%**	

Source: Powered by dataCentral

Regulatory improvement addresses political/regulatory risk, growth issues

The autumn of 2013 will likely see a flurry of mostly positive developments in Moscow for Russian oil & gas names, with the new gas tax law, the new offshore tax regime, and the liberalization of LNG exports all likely to receive final approval. Additionally, Gazprom's dividends may get another boost and gas exports to Europe should remain strong following a record summer. The one fly in the ointment? The likely 1-year freeze in gas tariff increases.

An autumn policy offensive

1) The offshore tax regime to be signed (growth - Rosneft)

Having been just approved by the Duma, the new offshore tax regime should, we fully expect, be signed into law by year-end and go into effect from January 1st, 2014. At last word, it is set to be introduced into the Duma in September or October, and we would expect final passage by December.

The broad strokes of the new tax regime have been public for months, but its passage could nonetheless provide a catalyst for primary beneficiary Rosneft and its 46 offshore licenses. Gazprom/Gazpromneft (the other traded state-owned company with the right to develop the continental shelf) and Lukoil (Caspian Sea) will also gain from the new law, but to a lesser extent relative to their current portfolio of projects.

New offshore tax law quite important for Rosneft

For Rosneft this law is quite important, as it will at least theoretically make offshore exploration and development economically feasible, something that is just not possible under the current regime. Although the current regime works after a fashion onshore, it takes too large a slice of the revenues of a produced barrel to justify the development of new onshore fields without significant tax breaks. Applied to offshore fields with their greater risks and investment requirements, the current regime simply doesn't work.

2) LNG liberalization (growth)

The second major policy goal that appears likely to be reached this autumn is the liberalization of LNG exports, whereby independent gas producers are allowed to export LNG around Gazprom's current legal monopoly on the export of gas in all forms. This would be a major boon to Novatek and Rosneft, two independent gas producers with large ambitions for the export market. .

We think LNG liberalization all but inevitable

We see LNG liberalization as highly likely for the following reasons:

- The Kremlin is already visibly fully behind the project, including extending tax breaks to the project denied Gazprom's Shtokman project. Backing out now would result in a loss of face that doesn't seem likely.
- Investment in the $2.3bn port of Sabetta began this summer, with 65% of the investment coming from the federal government and the rest from Novatek.
- A major purchaser of gas from Yamal LNG appears to have been found in new partner CNPC, whose purchase of a 20% stake should be finalized by early October, according to Novatek management, and who will presumably also step up as an anchor customer for gas from Yamal LNG.
- Rosneft, led by its very influential CEO, Igor Sechin, is now fully behind the push to liberalize LNG exports, as it needs that ability in order to monetize existing and expect gas assets:

- Rosneft and ExxonMobil begin test drilling the Kara Sea next summer – not far offshore from the Yamal Peninsula – where the companies expect to find substantial hydrocarbons, of which over half is likely to be gas. Without having the right to export LNG, those projects would likely be difficult to develop for their liquids alone.

- Rosneft and ExxonMobil have substantial gas in their Sakhalin-1 project for which there is no market. The two companies' announced plan to build an LNG plant by 2018 is likely intended to use this gas as a feedstock, we think.

Gazprom to only be marginally affected by LNG liberalization

Note that the emergence of independent Russian LNG exporters will be a negative development for Gazprom, but a modest one, we think. Although its full monopoly on gas exports will be lost, piped gas will remain the company's exclusive bailiwick, eliminating the possibility of Russian head-on-head competition for market share in Europe. Meanwhile, new LNG projects from Novatek and Rosneft would not enter the European market directly, but rather the global LNG market, with their products going to the highest bidder after allowing for transport costs. In the current market environment, that highest bidder is Asia, where spot gas prices are typically $5-$9/mcf higher than those in Europe. Even then, the great majority of the gas from these projects, particularly Novatek's Yamal LNG, will be pre-sold under long-term contracts, likely with oil-linked prices well in excess of what Europe is willing to pay.

Some non-Gazprom Russian LNG will make its way to Europe, we think, but only a relatively few marginal loads, and even those will likely be delivered under swap arrangements with other suppliers who in turn deliver gas to Asia to meet Novatek's or Rosneft's contractual obligations, not affecting the supply of LNG to Europe, but merely optimizing transport costs for both suppliers.

3) New gas taxation regime to be finalized and passed (risk, growth)

The new gas tax regime should also be approved this autumn, signed into law in time to go into effect by January 1st, 2014. As we wrote in May (Russian gas tax policy - Gas, condensate tax formula – Initial impression positive), we see this law as being a positive for all major gas producers on de-risking of new field development and for equity analysts as it decreases the uncertainty around long-term earnings power in a given oil price and macroeconomic setting, but especially Novatek (on de-risking condensate taxation as well as gas itself). The offshore regime will primarily benefit Rosneft.

Why we think the government's room for maneuver on taxation is very limited, and the read-across to Gazprom dividends

We think the government's ability to increase gas taxes substantially from current levels is actually quite limited. From statements reported in the press, we think that increasing gas export duties is likely to be off the table. Russia is now a member of the WTO, which frowns on the existence of export duties to begin with. Although Gazprom's duties on European exports have been grandfathered in, additional increases would be difficult to achieve.

4) Tight oil regime already passed (growth)

Deteriorating traditional reserves quality and recent shale development success in North America have sparked substantial interest around Russia's unconventional reserves opportunity. With these reserves holding the potential to be tangible and relatively quick way of supporting Russian crude oil production, in the first half of 2013 the government developed and introduced a set of tax exemptions aimed at supporting unconventional oil development. The corresponding law codifying a special tax regime for unconventional oil was passed by the Duma over the summer and signed into law by President Vladimir Putin in late July.

The government passed a set of tax exemptions supporting unconventional oil development this past summer

Even though the tax breaks will take effect only from Jan 1, 2014, several Russian oil majors, including Rosneft, Gazpromneft, Lukoil and SurgutNG, have already initiated significant pilot projects in unconventional reserves. In particular, Rosneft has established a special JV with ExxonMobil focused on unconventional reserves development in West Siberia. Gazpromneft is pursuing the same objective jointly with Shell, while SurgutNG (the pioneer of Bazhenov formations development in Russia), traditionally relying on its substantial in-house drilling and fracturing expertise, is apparently remaining independent while actively exploring the possibilities. Lukoil is conducting Bazhenov production experiments using the thermo-gas impact technology via its subsidiary RITEK at the Sredne-Nazymskoye field and also conducts horizontal wells drilling in combination with multistage fracturing, but has seemed less enthusiastic about the potential than the other companies mentioned here.

For a more detailed exploration of Russia's tight oil opportunities, please see our recent comprehensive note on Russia's OFS industry (Russian Oilfield Services, September 3, 2013).

Gazprom: Exports and dividends address growth and corporate governance

Gazprom, SurgutNG prefs remain Best Ideas

Our main thesis on GAZP is that the stock de-rated in 2009 due to the threat the US shale oil revolution and LNG glut presented to the company's its European franchise, which not only took growth out of the picture, but threatened outright reductions in prices and volumes. Although worries linger, we think they are being quickly resolved by surging European exports. Since 2009 a second issue has arisen – increasing investor exasperation with poor corporate governance, in particular seemingly extravagant reinvestment CAPEX. We think the sea change in dividend policy in 2011/12, and an increasingly likely additional 40% increase for next year, has materially improved Gazprom's score on corporate governance.

At this point, we think many investors have written Gazprom off as an investible stock due to a combination of those corporate governance issues and the seeming threat from the shale gas revolution.

We think this may be short-sighted, as we think two things – rising dividends and mounting evidence that Gazprom's position in the European market is surprisingly strong – may underpin a re-rating of the stock.

Gazprom's position on European market much better than recently thought

- **European exports:** With practically all non-Gazprom sources in decline, and in spite of weak demand, Europe is finding itself increasingly reliant on Russian gas to balance its market. We are becoming increasingly optimistic not just about Gazprom's near-term export opportunities, but about the long-term ones, as well. With this note we raise our 2013 European export forecast from 150bcm to 155bcm, after having raised it from 145bcm only recently. We also raise 2014-2015 forecasts to 155bcm, leaving our 2017 terminal assumption unchanged at 158bcm, Gazprom's published take-or-pay minimum shipments in its European contracts.

Increased dividends = improved corporate governance

- **Dividends:** since that de-rating in late 2009, Gazprom has experienced its first meaningful improvement in corporate governance that we can remember occurring in the 14 years we've been covering the company – it began paying real dividends in late 2011. Rather than being an inconsequential bit of window dressing, we argue that increased dividends are actually a critical improvement in Gazprom corporate governance practices, as higher dividends directly address a key (if not the key) criticism of the company made by investors – its wasteful spending of cash.

The significance of Gazprom's dividend increase

Gazprom's dividend increase(s) are important, first and foremost, because they significantly improve a key corporate governance metric – the return of cash to shareholders.

Historically, dividends have not been of major import for the Russian equity market, with yields often at or below 1% for most of the period since the 1990s.

However, in 2011 the government began to raise dividend requirements for state-owned companies, first requiring Gazprom to move to a 25% of RAS net income standard, and then tightening up the definition of net income to limit management's ability to manage down profits. This resulted in a sea change in Gazprom's dividend (Figure 4), and on that policy we today expect Gazprom to pay around RUB8/share next year on 2013 earnings, or a c5.4% yield on its current price.

That puts Gazprom in good company, as a number of companies in the Russian oil & gas universe have expected yields in that range (Figure 9), with Gazprom, Gazpromneft, Lukoil, Bashneft, and Tatneft pref all yielding in that general range.

Although not yielding as much, Rosneft has played a notable role in increasing investor expectations for dividends from Russian oil & gas companies. With the arrival of Igor Sechin in 2012 as CEO, Rosneft moved almost immediately to paying

25% of IFRS net profit as dividends, going as far as paying a supplementary dividend – which was larger than its initial dividend – in the second half of the year to bring its total payout on 2011 earnings to 25% of IFRS net profit, a policy the company kept for its most recent dividend and which management has repeatedly reiterated is here to stay.

While not explicitly targeting a 25% payout, Lukoil over the last year has broken out of its decade-long payout range of 15-20%, inching up to 22% this year on 2012 earnings and apparently on track to get closer to that 25% mark for 2013E earnings (in early August Lukoil unexpectedly declared a RUB50/share interim dividend, a 5% annualized yield on the prevailing price). We think Gazprom is next on the list to move to 25% of IFRS, a view supported by recent newsflow that the political decision to do so has already been taken at the highest levels, including by Russian President Vladimir Putin and PM Dmitri Medvedev.

How Gazprom sets it capital budget – Dividends come before CAPEX

Higher dividends equal a major corporate governance improvement

We think it is critical that investors understand that under Gazprom's capital allocation policy, in a typical year dividends take a higher priority than CAPEX. That is, dividends are determined and set aside early in the fiscal year (being payable on the previous year's earnings), while the rest of the cash generated in the course of the year is usually invested into projects of various levels of attractiveness.

This policy has a number of implications for investors:

Dividends come before CAPEX…

1) **Dividends and CAPEX are not in conflict:** Gazprom's approach is precisely the reverse of what many investors assume. We have constantly run across the comment that "Gazprom can't raise dividends, as the CAPEX budget leaves no cash available". In reality, there is no conflict, as the cash for dividends is budgeted at the start of the year, with Gazprom then reinvesting any and all excess cash that the business throws off in the course of the year. To see an illustration of that, refer to Figure 11, which shows that, while Gazprom has outspent cash flows a couple of times in the past, it has never suffered cash to remain on the table.

…so the higher the dividend, the less cash can be poorly reinvested

2) **By definition, raising dividends displaces the lowest-priority (and presumably lowest-return) CAPEX of the year:** We think Gazprom de-rated in late 2009 due to the threat to the company's core profit center – the European gas market – from the LNG glut that hit the market that year. However, many investors' major complaint about Gazprom in recent years has not been that apparent threat to the bulk of the company's profits, but rather the likelihood that the company will reinvest generated cash in value-destructive projects. The higher the dividend, the less cash remains for Gazprom management to invest at a rate of return below its cost of capital, and therefore the more the stock should be worth.

   Any increase in dividends, therefore, comes directly from the traditional investment budget increase(s) in September and December, increases that are typically used to absorb any cash generated above and beyond that needed to: a) meet dividends, and b) fulfill the initial, purposefully conservative, investment budget set out at the beginning of the year.

Dividends = Free Cash Flow for Gazprom

3) **Dividends equal Free Cash Flow:** Looking at Figure 11 again, and bearing in mind that all cash flow after dividends is historically reinvested into the business, then *by definition dividends equal Free Cash Flow*. Therefore, increasing dividends necessarily increases FCF, assuming no change in debt levels.

Second, the increase has already been very large

Gazprom has already had one sea change improvement in dividend policy

The sea change in Gazprom's dividend policy in 2011 made a significant difference in the amount of cash being returned to investors, boosting dividends from RUB2.4/share in 2010 (on 2009 earnings) to RUB3.85 in 2011, and RUB8.97 in 2012, when the new policy went into full effect.

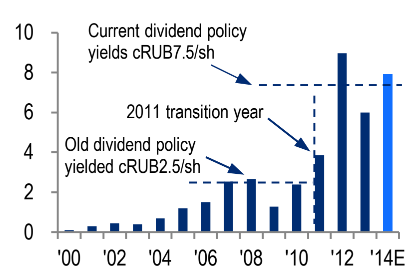
This year's dividend of RUB5.99/share came in 33% below that 2012 number, with the drop driven by a combination of higher taxes (which went into effect in January of 2012), lower European exports (as temperatures moderated after a cold 2011), and several billion dollars of retroactive payments to European customers (due to back-dated discounts agreed to by Gazprom).

The market found this dividend level disappointing, mostly because Gazprom management had been guiding for a RUB7-8/share dividend during annual marketing in February. However, in the process of punishing the stock for management's poor guidance, we think that investors may have lost sight of the fact that Gazprom is now paying dividends at an entirely different level than it was prior to the 2011 reforms, as this "disappointing" dividend was still more than double the size of the highest-ever pre-2011 dividend of RUB2.66/share in 2008 (Figure 10).

This is what we mean by sea change: Dividends under *current* policy 3x higher than pre-2011 levels…

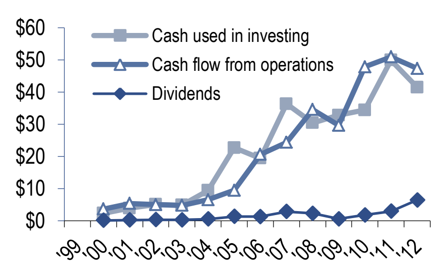
Looking more closely at that graphic, note that in 2007-2010, leaving out the crisis-influenced dividend paid in 2008, Gazprom's average dividend was cRUB2.5/share. After the change, and leaving out the transition year of 2011, the average dividend (including our estimate of 2014 dividends to be paid on 2013 earnings under the current policy) looks to be in the range of RUB7.5/share, or 3x higher. This is what we mean by a sea change in policy.

Figure 10. Gazprom dividends, RUB/share



Source: Gazprom, Citi Research estimates

Figure 11. Gazprom's OpCF, CAPEX, divs, $bn



Source: Gazprom, Citi Research

Third, dividends will most likely grow at least c40% larger

…and set to rise another 40%+

The dividend revolution at Gazprom is likely not yet over, as we think it is highly likely that the government will push through on its official target of having all state-owned companies pay 25% of IFRS net income (or fully-consolidated RAS net income) out to shareholders.

If the government were to raise dividend requirements to 25% of IFRS net income, which is now looking increasingly likely (Gazprom dividends set to rise, government "takes decision" to raise payout to 25% of IFRS), in a typical year we calculate this would result in a 40% increase[3] in the dividend itself.

[3] As RAS operating income and clean net income (ignoring any non-cash paper losses) are usually 70% of IFRS levels, the 25% of RAS dividend policy equates to a 17.5% of IFRS policy. Therefore, increasing that policy to 25% of IFRS is a 25/17.5-1=40% increase in dividends.

Looking at Figure 10 again, this implies that, all else being equal, the proposed dividend policy would result in a jump in Gazprom's per-share dividends to 10-11 RUB/share, over 4x higher than pre-2011 levels in addition to being 40% above levels likely to be seen under the current policy. On the current stock price of RUB145/share, this would imply dividend yields of c6.9% to c7.6%.

Gazprom export update – Going from strength to strength

Gazprom exports should continue to be strong as Europe continues to scramble to refill exports in the face of dwindling non-Gazprom supply options (LNG, Norway, N. Africa, etc.) and stabilizing demand. Is it yet time to start thinking of Gazprom's exports to that region in terms of growth rather than the potential for shrinkage?

We raise our 2013 export forecast from 150bcm to 155bcm

We raise our export forecast for 2013 from 150bcm to 155bcm. By itself, this raises our 2013E EBITDA for Gazprom by a relatively modest c$820mn or c2%. However, the sentiment impact for the stock should be substantially greater than that due to the implications for Gazprom's negotiating position vis-à-vis its European customers.

The implication that Gazprom's oil-linked contract pricing will likely remain intact is more important than the additional volumes themselves

In our view, these strong export numbers underline that the non-Gazprom sources of gas for Europe are quite limited – indeed, we think they are shrinking. In turn, that implies that, not only are export volumes stabilizing, the likelihood that Gazprom will have to make any significant price concessions in the medium term is quite low. As Gazprom is more price-sensitive than volume-sensitive, the implication that Gazprom's oil-linked contract pricing will likely remain intact is more important than the actual volumes themselves.

Ukraine volumes likely stable at current levels of c28bcmpa, but with high margins

Meanwhile, Ukraine is finally ramping up its own gas off-take, having delayed the process as much as possible YTD through the end of August. We think there is little downside left there, although growth from current levels also seems unlikely – in light of the high prices it is paying, we think it will have reduced its Russian offtake to the irreducible minimum, given the makeup of its industrial needs for chemical feedstock and fuel. Even if the long-negotiated price adjustment is finally reached, we think the country's imports of Russian gas are unlikely to rise enough to do anything more than offset the price decline, and Gazprom's overall earnings from the country will be unlikely to change much (we think this explains why Gazprom hasn't been in any particular hurry to reach a deal).

Why domestic market share losses just aren't all that important

Domestic sales volumes continue to decline, and tariff increases will apparently hit their first hiccup in over a decade come next year. However, while earnings growth from the domestic gas market seems unlikely, the downside is also limited, in our view. This is due mostly to the fact that Gazprom retains significant revenues from every unit of gas sent through its pipeline system.

For example, if the company loses a thousand cubic meters of sales to an independent producer, it does indeed lose c$100 of revenue up front. However, costs are decreased by c$20 via the Mineral Extraction Tax (we think most other costs are largely fixed), and Gazprom will get on average c$45 back in the form of the transport tariff from the independent producer. Therefore, rather than losing $100/mcm, Gazprom has lost no more than c$35. Therefore, we gauge that a 10bcm loss of market share would lead at most to only c$350mn of EBITDA loss for Gazprom, even assuming that all of its gas production costs are fixed. To the extent those costs are variable, that number will be reduced.

SurgutNG prefs: Still a favorite

As we published in early September (SNGSp.MM: It's T+2 Day. Upgrading TP on Lower Pref Discount), we see SurgutNG preferred shares as remaining one of the best opportunities in the Russian oil & gas space.

- **T+2 should improve access to the preferred share for international investors:** We see the introduction of T+2 trading in early September leading to an acceleration of the convergence of the preferred price with the common seen over the last 3 years (Figure 12), as it should increase the availability of the stock to international investors. Historically a number of international investors have been effectively blocked from owning SurgutNG's preferred shares due to a combination of: a) a lack of T+2 settlement, which kept them from trading locally; and b) a severe lack of liquidity in the prefs unsponsored ADR traded in New York.

- **Dividend still the core return generator for SurgutNG prefs, set for large y-o-y increase:** We have cause for optimism that the dividend will rebound sharply this year, supported by a weak ruble YTD. In the event, assuming current ruble levels remain until year-end, we calculate that SurgutNG will pay RUB2.6/sh to preferred holders, showing a yield of 11.8% on the current stock price.

The reliable return from SurgutNG prefs is the dividend

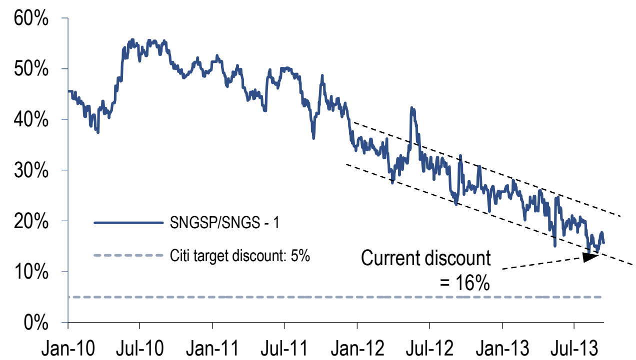
Note that this dividend is materially supported by recent ruble weakness. If current ruble levels are maintained through December 31st, SurgutNG should book a substantial paper gain on the company's largely USD-denominated $32bn cash pile of maybe $2.5bn, following a c$2bn forex *loss* booked in 2012. That potential $4.5bn swing is the primary driver behind what we anticipate to be a near 70% y-o-y increase in the preferred dividend on last year. This is well above the record high preferred of RUB2.15/sh paid out in 2012 on 2011 earnings (Figure 13).

In spite of the support given to the dividend this year by a weaker ruble, on a year-in, year-out basis this effect averages out, and the stock's guaranteed 40% pro-rata payout will give maybe a 9% yield on today's price.

- **At these levels we think SurgutNG equity in general is highly defensive:** The current combined market cap for SurgutNG's two share classes stands at $35bn, only fractionally above its cash pile of c$32bn. As we show in Figure 14, the cash level of SurgutNG has historically acted as a reliable trading floor for the company's equity on a combined basis. While there is no iron-clad law this will hold true in the future – equity markets will do what they will – it nonetheless gives us confidence the stock represents a relatively safe instrument for gaining exposure to the Russian oil & gas sector.

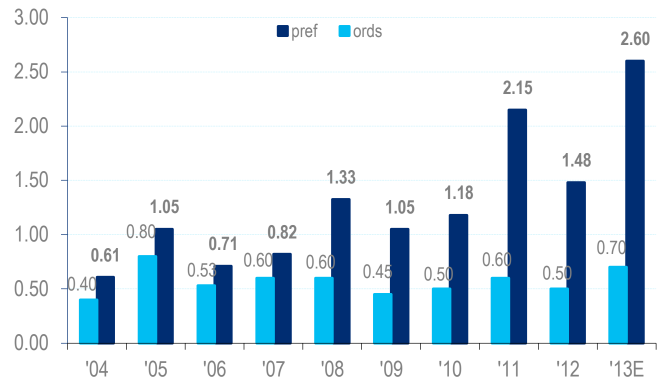
  This is doubly so given that dividend expectations often rise when the overall Russian macro picture is deteriorating: As pointed out above, if the ruble is getting weaker, then SurgutNG will see a net income boost from FOREX gains, which automatically feed through to higher preferred dividends.

Figure 12. SurgutNG's pref/common discount continues to contract



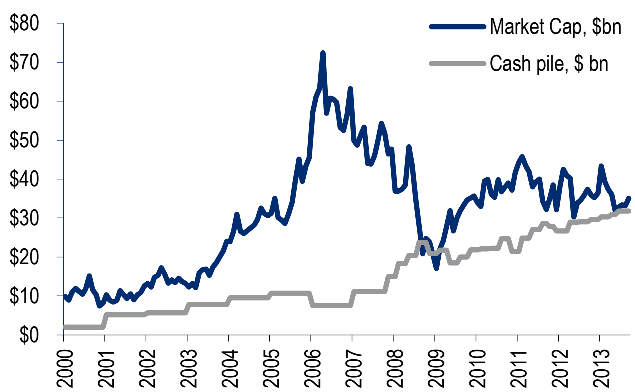
Source: Bloomberg, Citi Research

Figure 13. SurgutNG dividends, RUB/sh



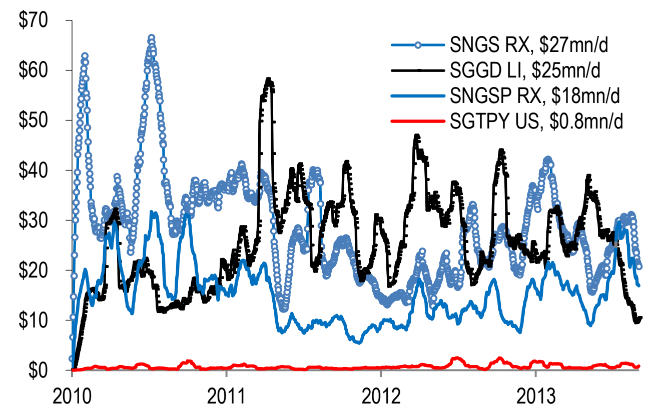
Source: Company data, Citi Research
Note: Year indicates financial year on which dividend paid, not the year actually paid out (ie, 2012 pref dividend of RUB1.48 was paid in summer of 2013 on 2012 results).

Figure 14. SurgutNG's cash pile vs. market cap, $bn



Source: Bloomberg, Citi Research
Note: Total market cap includes both the common and preferred shares, assuming that all issued shares are outstanding (i.e., no treasury position)

Figure 15. Liquidity of SurgutNG's various tickers, $mn/d



Source: Citi Research
Notes: 1) data in chart smoothed (1-month trailing averages); 2) $mn/d numbers shown in key indicate average daily trading volume YTD

SurgutNG cash pile: Why – and how – we give it a haircut

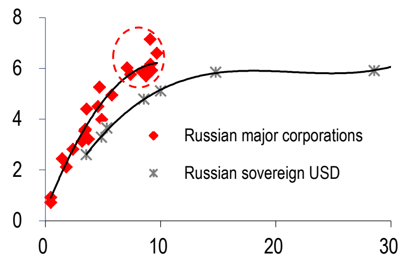
The 'cash pile' is there, we know that, some $32bn in total. We were confident that cash existed even before the IFRS accounts came out, and they only confirmed that level. For calculating our EV/EBITDA numbers, we leave the full cash number in there – it is a real asset with an easily discernible value, and we it instructive to see a multiple near zero.

However, for our DCF valuation we feel the need to give a haircut to that cash pile for the following reason: Due to past behavior by management, a substantial part of that cash will likely never be employed or returned to shareholders, nor can it be justified as a deep reserve for a (very) rainy day. Generating low returns, and while low-risk, this cash is worth less than its face value to investors based solely on the cash flows its generates.

How we do it

SurgutNG has a c$32bn cash pile per its last report. Of that, we are willing to set aside $5.0bn as being necessary for working capital and an emergency fund in case of a sustained correction in oil prices. Another $5.0bn we are willing to reserve for East Siberian development – the company has ambitions in the region, and it is possible that its cash needs could outstrip its ability to generate cash for a time as its expands operations in the region. That leaves us with $22.0bn of excess cash on the balance sheet that we think is unlikely to either be employed in the company's core business or return to shareholders in the form of a dividend.

Figure 16. Russian yield curve, YTM%



Source: Bloomberg, Citi Research

We estimate that, in the current environment, SurgutNG could command perhaps as much as a 4% rate from Sberbank on a deposit (the bulk of its 'cash pile' sits with Sberbank and VTB, per its IFRS accounts), which annually means the excess cash is generating $880mn of interest. We now need to estimate the value of this cash to the equity investor. However, we don't think we can use a standard cost of equity for this task, as it would overstate the risk around this asset: It can't be less than face value, while an investment into an oil field with all its geological and oil price risks certainly can, for example. It may generate low cash flows, but they are highly certain.

We suggest using SurgutNG's own cost of debt, were it to go onto the market to borrow. Per Russia's corporate debt curve for USD-denominated issuances (Figure 16), SurgutNG could probably borrow today at around 6.4%, were it to want to. Discounting that $880mn of interest in perpetuity using a 6.4% discount rate gives us a value to equity holders of that excess cash of $13.8bn, or an $8.2bn haircut on SurgutNG's cash pile.

Raising long-term oil price assumptions

We are raising our long-term oil price assumptions following a similar move by Citi's European team in late summer. In particular, we are increasing our 2017 oil price from $80/bbl nominal to $90/bbl real or, after allowing for inflation, to $102/bbl nominal. While this pushes up revenues for our Russian oil & gas companies, it does not have an overly dramatic effect on our DCF valuations, due to higher expected inflation and taxes associated with higher oil prices. Our near-term multiples-based valuation indications are largely unaffected as they are based on 2013 earnings forecasts, which are not materially affected.

Figure 17. Oil assumption changes

	1Q13	2Q13	3Q13E	4Q13E	1Q14E	2Q14E	3Q14E	4Q14E	2012	2013E	2014E	2015E	2016E	2017E
Brent crude, $/bbl														
Old	$113	$103	$105	$103	$103	$103	$103	$103	$112	$105	$100	$90	$80	$80
New	$113	$103	$105	$100	$100	$95	$100	$95	$112	$105	$98	$93	$99	$102
Average RUB/USD														
Old	30.4	31.6	31.7	30.6	30.6	30.6	30.6	30.6	31.1	31.1	32.2	33.7	35.0	35.0
New	30.4	31.6	32.9	33.5	33.8	34.1	34.1	34.1	31.1	32.1	33.9	34.4	34.3	33.5

Source: Citi Research

DCF valuations rise modestly

Higher revenues offset by higher costs, stronger ruble

Oil price increases do not happen in a vacuum, especially in Russia, and a higher price will be largely offset – although not entirely – by higher costs. Below we detail the costs that are linked more or less directly to oil.

Higher taxes

Much of the nominal revenue gain is offset by higher taxes, especially in the upstream where the government takes c86% of any nominal increase in oil prices on export routes. Downstream margins do rise, however, due to the arbitrage inherent in export duty regime, clawing some part of that back, depending upon the refining exposure of the company in question.

Higher inflation

A higher assumed oil price, and an oil price that will rise with USD inflation (as our real $90/bbl assumption stipulates), should also result in somewhat higher oilfield inflation, as well, relative to our previous assumptions. We raise our overall base inflation assumption – underlying plus oilfield – from 7% pa to 8%.

Higher replacement costs:

A key assumption – if not the key assumption – in all of our DCF valuations of Russian oil companies is the cost of replacement of the produced barrel. In a generally higher oil price environment, we cannot see how replacement costs won't be higher, as well, partly from higher inflation and partly from the fact that higher oil prices will allow companies to push into more marginal oil plays.

- **Lukoil – from $9/bbl to $10/bbl:** We had previously assumed that the application of higher technology (horizontal wells and multi-stage fracturing) to Lukoil's large portfolio of lower-quality reserves and/or smaller conventional fields would allow it to drop its replacement cost from historical levels of c$10/bbl (when the company was investing sufficiently to maintain production) to $9/bbl. However, that assumption was partly underpinned by the idea that oil prices would retreat somewhat over time, helping to keep OFS costs under control. We now assume that higher technology will only help maintain replacement costs around that $10/bbl level as the quality of remaining reserves progressively

deteriorates, rather than lowering them. This additional dollar, given our normalized (2017) production forecast of 2.1mmbpd, adds c$750mn to annual maintenance CAPEX, lowering our DCF by c9%, all else being equal.

- **Rosneft – from $8/bbl to $9/bbl:** Given its younger key fields – especially those in 1.3mmbpd YuganskNG (Priobskoye) and 440kbd Vankor – and an equal access to technology, we continue to think that Rosneft will have a sustainable advantage on Lukoil on replacement costs, which we have long assumed to be in the range of $1/bbl. However, Rosneft is subject to the same market forces that Lukoil is exposed to, and so we raise that company's replacement costs assumption by $1/bbl as well, to $9/bbl. This increase, coming off a lower base ($8/bbl instead of $9/bbl with Lukoil) has a larger, 16% impact on our Rosneft DCF valuation, all else being equal.
- **Gazprom – from $2.7/boe to $3.3/boe:** Although a smaller $0.40/boe than the $1/bbl we add for Lukoil and Rosneft, coming on Gazprom's lower base (and lower EBITDA per boe) this still has a significant effect, lowering Gazprom's DCF by 10%, all else being equal.

For Gazprom, limits to what the European gas market can bear

In spite of oil-linked contracts, higher oil prices long-term don't fully translate into higher gas prices

We think that gas will remain a premium product on the European market for the following reason: The region is a large and growing gas importer, with LNG providing the marginal unit of non-Gazprom fuel. LNG is not a cheap form of delivering gas, and therefore gas in Europe will remain relatively dear, we think. We also continue to think that Gazprom will continue having success in defending its existing oil-linked contracts in general.

However, sustained high oil prices will keep pressure on the profitability of Gazprom's customers. Therefore, should oil prices remain at or above $100/bbl, we'd expect continued negotiations on the oil price coefficient (or "slope") in those contracts, while we had previously assumed that easing oil prices would relieve that pressure. As such, we are lowering our estimated oil slope from 10.8% to 10.0%.

For the uninitiated, a slope of 10% means that, if oil is at $100/bbl, then gas under that contract will be priced at $10/mcf ($353/mcm). In this case, lowering the slope from 10.8% to while raising our nominal oil assumption from $80/bbl to $102/bbl still results in an increase in our assumed European export price, but from /mcf to /mcf rather than to the /mcf we would have otherwise seen.

This puts our normalized gas price assumption in the range of current European spot prices in the low-$10/mcf range, but below mid-term futures prices of $11/mcf (themselves largely set by Gazprom's current contract parameters and the current price for oil, we think, so potentially not a good market signal for predicting the market-clearing price for gas in Europe).

Benchmarking our European gas price assumption off of Henry Hub

European floor price $8/mcf – US shale exports:

As a benchmarking exercise, a European floor price can be set using US prices, the tolling price imbedded in the contracts of Cheniere Energy (the company pioneering LNG export from the US), and normalized LNG shipping prices, using the following formula: Landed Price = 1.15*Henry Hub + tolling charge + shipping charge + re-gasification charge.

Henry Hub: Everyone has their own opinion of a normal price for Henry Hub pricing, with most agreeing that prices will need to be at least somewhat higher than current levels once the current oversupply is worked through. For this exercise we

will use $4/mcf on a full-year basis, only modestly higher than the current level of $3.6/mcf. We think that $5/mcf might actually be a better long-term number, if for no other reason than that the addition of LNG exports will in and of itself add a significant dollop of demand to the US supply/demand balance.

- **Tolling:** Cheniere's tolling charge on most of its contracts has been $3/mcf. As this project is a conversion of an import facility conveniently located near Henry Hub, it likely represents near the low end of possible outcomes for new facilities, with greenfield plants likely requiring a higher tolling charge to cover the cost of not only the liquefaction trains but storage and port facilities.
- **Shipping:** Current shipping charges from Trinidad & Tobago to Europe are running about $1.1/mcf per Bloomberg. However, these are exaggerated due to the current shipping shortage, and might come down to $0.6/mcf in a normalized situation, we think.
- **Re-gas charges:** It is not sufficient to land LNG in Europe, it also has to be turned back into gas fit for injection into the continent's pipeline transport system. Typically, those charges are around $0.4/mcf, per POTEN data.

With those numbers, each of them conservative in their own way, US gas landed in Europe would need 1.15*$4.0+$3.0+$0.6+$0.4=$8.6/mcf to break even on the trade. This to us represents a fairly firm floor for European pricing over any reasonable time frame. If US gas prices rise to c$5/mcf, something that seems reasonable to assume for the longer term, then that breakeven trade rises to $9.8/mcf, very close to our normalized number for Gazprom in Europe.

Summary of TP changes

Below we summarize the increases in our target prices driven by the change in our long-term oil price assumption. In general, our multiple-based targets haven't been much moved, except to the extent that our near-term earnings expectations have evolved in recent months. Our DCF valuations, as a rule, have risen, although that effect has been muffled by the fact that the DCF makes up only half of our TP-setting mechanism.

In summary:

- The largest increases were seen in Lukoil, which with older, higher costs fields benefits more than Rosneft from a marginal increase in oil prices on full-cycle economics, and in Gazpromneft, which saw us increase near-term earnings forecasts a bit more than the other companies due to company-s
- The smallest gains came for Novatek and Rosneft. Novatek has relatively limited direct exposure to external oil prices because of its large component of domestic gas sales in its revenue stream, which are both set in rubles and are decreased by the lack of tariff growth in 2014. Rosneft, with its significant gas ambitions, also saw its DCF valuation impaired somewhat due to the new gas price assumptions.
- Otherwise, increases in TPs ranged from a 4% drop to a 9% gain, with most TPs rising 6%-7%.

Figure 18. Summary of TP changes

	New DCF	P/E TP	EV/EBITDA TP	Total weighted TP	Current price	ETR*	DCF old	Change	Old TP	Change
Alliance	74.7	40.3	50.2	**60.2**	48.5	24%	65.8	14%	62.7	-4%
Bashneft	$82.5	$75.9	$76.1	**$79.2**	$59.0	41%	$72.7	13%	$74.2	7%
Gazprom	$7.9	$7.3	$6.8	**$7.5**	$4.4	77%	$7.0	12%	$7.0	7%
Gazprom Neft	$6.9	$5.5	$5.9	**$6.31**	$4.4	50%	$6.3	10%	$5.77	9%
Lukoil	$98	$75	$82	**$88**	$62	47%	$82	20%	$81	9%
Novatek	$189	$138	$141	**$163**	$130	27%	$181	4%	$163	0%
Rosneft	$10.5	$7.0	$8.1	**$10.0**	$8.0	29%	$9.4	12%	$9.2	9%
SurgutNG	$1.24	$1.38	$1.12	**$1.24**	$0.83	52%	$1.07	16%	$1.17	6%
SurgutNG pref				**$1.18**	$0.70	80%			$1.11	6%

Source: Citi Research
Note: Rosneft TP includes $0.99/share for our estimated value of the company's 46 offshore licenses

Company Focus

Alliance Oil (AOILsdb.ST)

Still Neutral on High Risk

- Rating Change
- Target Price Change
- Estimate Change

Neutral/High Risk	**2H**
from Neutral	
Price (13 Sep 13)	SKr48.50
Target price	SKr60.20
from SKr62.70	
Expected share price return	24.1%
Expected dividend yield	0.0%
Expected total return	**24.1%**
Market Cap	SKr8,319M
	US$1,268M

Price Performance
(RIC: AOILsdb.ST, BB: AOIL SS)

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption change increases our DCF by c14%, but our overall weighted TP actually falls c4% to SEK60.2/share due to declines in our multiple-based targets, the latter driven by FOREX-related earnings declines. We expect no dividend in the medium term, which means our expected total return (ETR) is equal to the upside to our TP at 24%.

- **Recommendation maintained at Neutral:** We maintain Alliance at Neutral, but we attach a High Risk flag to our Neutral rating to reflect: a) delays with the Khabarovsk refinery modernization completion and b) recent press reports that Rosneft may be looking to buy into Alliance Oil and/or part of its business, which, even if true, might not necessarily bode well for Alliance Oil minority shareholders. Although our target price implies some modest upside potential, it is insufficient to warrant a Buy rating given the risk we see.

- **Alliance and the 3 discounts**

  – **Growth:** Alliance's growth is limited on the oil side due to the declines seen at its mature core asset base, including the once-promising Kolvinskoye field. The company is targeting a 10% compounded annual production growth rate going forward, but that is driven mostly by gas, and in any event this is captured in our DCF. Elsewhere, the completion of the company's refinery upgrade should improve cash flows beginning in early 2014.

  – **Political risk:** We think AOIL has middle-of-the-pack political risk, at least as we define it, being no more or less exposed to regulatory volatility than the average Russian oil & gas company.

  – **Corporate governance – Potential M&A target:** Press reports have indicated that AOIL could be a target for M&A activity, although rumors of a takeover by Rosneft were quickly denied by that company. We don't see as a potential catalyst for the stock, as there is no guarantee that any acquirer would achieve a price greater than today's market price, or that minorities would be offered a similar price.

Alliance Oil (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	3,082.7	3,445.2	3,537.7	3,690.6	3,692.3
Net Income ($M)	318.9	397.1	120.2	244.1	365.2
Diluted EPS ($)	1.69	2.11	0.70	1.42	2.13
Diluted EPS (Old) ($)	1.69	2.11	1.64	2.31	2.19
PE (x)	4.4	3.5	10.5	5.2	3.5
EV/EBITDA (x)	3.5	4.0	4.6	3.8	2.9
DPS ($)	0.00	0.00	0.00	0.00	0.00
Net Div Yield (%)	0.0	0.0	0.0	0.0	0.0

Company Focus

- Target Price Change
- Estimate Change

Buy	1
Price (13 Sep 13)	US$58.99
Target price	US$79.20
from US$74.20	
Expected share price return	34.3%
Expected dividend yield	7.6%
Expected total return	**41.9%**
Market Cap	US$11,131M

Price Performance
(RIC: BANE.MM, BB: BANE RM)

Bashneft (BANE.MM)

Dividends rising, circular ownership to be eliminated

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption change increases our DCF by c13%, but our overall weighted TP rises a smaller 7%/share. Including an expected 7.6% dividend yield, our expected total return (ETR) is 42%.

- **Recommendation maintained at Buy:** Our investment thesis for Bashneft remains intact, and we maintain our Buy rating on the stock. For more details, see our recent upgrade of the stock see (Bashneft (BANE.MM) - Upgrade to Buy as IPO preparation evident: Dividends rising, circular ownership to be eliminated, September 9).

- **BANE and the 3 discounts**

  – **Growth:** Bashneft's main growth driver will be the launch of the Trebs & Titov fields, where test production is already getting under way. Plateau production should occur in 2016 and hit c68kbd net to Bashneft vs. 315kbd today. We also think that the company may have opportunities under the recently-passed tight oil tax breaks, given its very mature asset base in the Urals region.

  – **Political risk:** We think BANE has middle-of-the-pack political risk, at least as we define it, being no more or less exposed to regulatory volatility than the average Russian oil & gas company.

  – **Corporate governance:** During the most recent conference call, Bashneft management made two key announcements materially affecting our view of the stock: The resumption of generous dividends in 4Q13; and the elimination of the circular ownership via Sistema-Invest. Additionally, the divestment of the petrochemical and OFS businesses should significantly simplify Bashneft's business structure and open the door for a public placement, which the company has confirmed is on the agenda. The pre-IPO optimisation process seems to be occurring, and there are a number of potential catalysts remaining to boost Bashneft's shareholder value, we think.

Bashneft (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	16,549.0	17,122.3	16,633.8	16,166.1	16,270.8
Net Income ($M)	1,696.0	1,674.9	1,849.4	1,626.9	1,713.9
Diluted EPS ($)	9.07	9.13	9.77	8.60	9.05
Diluted EPS (Old) ($)	9.07	9.13	9.77	8.56	8.61
PE (x)	6.5	6.5	6.0	6.9	6.5
EV/EBITDA (x)	4.9	4.4	4.2	4.4	4.3
DPS ($)	3.36	0.77	4.07	3.58	3.77
Net Div Yield (%)	5.7	1.3	6.9	6.1	6.4

Company Focus

- Target Price Change
- Estimate Change

Buy	1
Price (13 Sep 13)	US$4.38
Target price	US$7.50
from US$7.00	
Expected share price return	71.0%
Expected dividend yield	5.5%
Expected total return	**76.5%**
Market Cap	US$100,627M

Price Performance
(RIC: GAZP.MM, BB: GAZP RM)

Gazprom (GAZP.MM)

Exports booming, dividends set to rise – Still a Best Idea

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption change increases our DCF by c12%, but our overall weighted TP rises a smaller 7% to $7.5/local ($15/ADR). Including a 5.5% dividend yield, we see an expected total return of 77%.
- **Recommendation reiterated at Buy:** We maintain Gazprom at a Buy and one of our two Best Ideas in Russian oil & gas. Key catalysts over the next 12 months include: 1) an improving supply/demand balance in Europe, leading to improved exports and gradual de-risking of Gazprom's oil-linked pricing formulas; 2) an agreement on pricing for Chinese exports, allowing the project to finally move forward and giving a good home to c$60bn of Gazprom investment over the next decade or so; 3) an concrete commitment by the government to require Gazprom to move its dividend policy to 25% of IFRS net income.
- **Gazprom and the 3 drivers of Russian discount...:** In all three cases we can make a case that the situation is improving, at least somewhat:
  - **Political risk:** The proposed gas tax law will remove the substantial risk of bureaucratic whim that has existed since the company's inception, de-risking to a substantial degree future earnings on existing assets and the returns on new fields to be developed.
  - **Corporate governance:** We argue that Gazprom's sea change in dividend policy in 2011 has already materially improved the company's corporate governance score, although that has yet to be reflected in its stock price. A second step to 25% of IFRS would be a game changer, in our view.
  - **Growth:** The stabilization and now rebound of European exports substantially reduces the risk that Gazprom will see shrinking earnings in its key franchise, even if it's a bit early to start talking about a resumption of growth.

2013 European export assumption increased to 155bcm: Up from 150bcm, this is the second increase in two months, and boosts our 2013 EBITDA by c$820 or c2%, all else being equal. This is ahead of Gazprom's 152-3bcm official target, but below the off-the-cuff 160bcm number mentioned by CEO Miller this summer. That 160bcm number is possible, given the relatively tight supply/demand balance in Europe – and would be a record – but would require exports to not miss a beat the remainder of the year, and is too dependent upon weather and market forces such as oil prices to be predicted with any certainty.

Gazprom (USD)

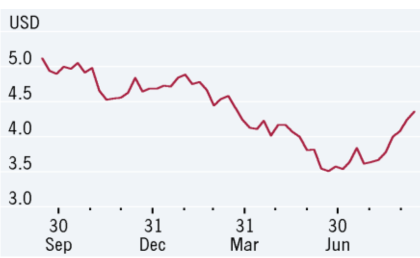
Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	157,661.0	153,514.2	144,666.1	137,941.3	137,707.5
Profit Before Tax ($M)	57,032.7	47,028.3	39,713.0	32,971.4	30,868.9
Diluted EPS ($)	1.93	1.59	1.35	1.11	1.04
Diluted EPS (Old) ($)	1.93	1.59	1.34	1.18	1.19
PE (x)	2.3	2.8	3.3	3.9	4.2
EV/EBITDA (x)	1.8	2.3	2.5	2.9	2.9
DPS ($)	0.30	0.19	0.25	0.19	0.25
Net Div Yield (%)	7.0	4.4	5.7	4.3	5.8

Company Focus

- Target Price Change
- Estimate Change

Buy	1
Price (13 Sep 13)	US$4.39
Target price	US$6.31
from US$5.77	
Expected share price return	43.9%
Expected dividend yield	5.7%
Expected total return	**49.6%**
Market Cap	US$20,794M

Price Performance
(RIC: SIBN.MM, BB: SIBN RM)



Gazpromneft (SIBN.MM)

Solid upside, rapid growth, and dividend yield

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption change increases our DCF by c10%, but our overall weighted TP rises a smaller 9% to $6.3/share. Including an expected 5.7% dividend yield, this gives us an expected total return (ETR) of 50%.

- **Recommendation maintained at Buy:** We maintain Gazpromneft at a Buy. Although its ETR is better than average in our universe, the somewhat low daily liquidity of c$7mn/day may put off some investors.

- **Gazpromneft and the 3 discounts**

  - **Growth:** Gazpromneft scores unusually well on growth, with ambitious plans to raise production to 100mn toe (2mn boepd) by 2020 – 67% above 2012 levels – it is more than a match for Novatek in this category. However, we feel the market is unlikely to give it full credit for its growth potential while the company is running through the period of high CAPEX needed to underpin that growth. Peak CAPEX is likely to run through 2015.

  - **Political risk:** Gazpromneft has middle-of-the-pack political risk, at least as we define it, being no more or less exposed to regulatory volatility than the average Russian oil & gas company.

  - **Corporate governance:** In keeping with informal government policy not yet reflected at the parent, Gazprom has Gazpromneft paying 25% of IFRS net income as dividends.

- **Consolidation of subsidiaries boosts near-term forecasts** — Gazpromneft is now consolidating subsidiaries Tomskneft and Salym Petroleum, which affects our simple calculation of EBITDA. This is the primary reason behind the increase in our 2014 EBITDA.

Gazpromneft (USD)

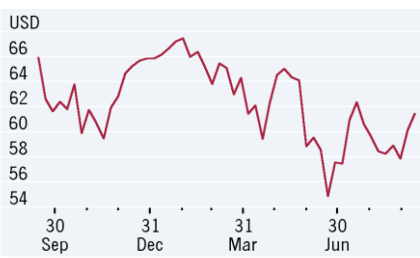
Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	43,887.8	48,852.5	44,372.3	44,459.7	45,382.2
Net Income ($M)	5,449.0	5,677.1	4,675.4	4,710.4	3,629.4
Diluted EPS ($)	1.15	1.20	0.99	1.00	0.77
Diluted EPS (Old) ($)	1.15	1.20	0.92	0.82	0.61
PE (x)	3.8	3.6	4.4	4.4	5.7
EV/EBITDA (x)	na	2.5	2.6	2.7	3.1
DPS ($)	0.25	0.30	0.25	0.22	0.17
Net Div Yield (%)	5.7	6.8	5.6	5.0	3.9

Company Focus

- Target Price Change
- Estimate Change

Buy	**1**
Price (13 Sep 13)	US$61.81
Target price	US$88.00
from US$81.00	
Expected share price return	42.4%
Expected dividend yield	5.1%
Expected total return	**47.5%**
Market Cap	US$47,868M

Price Performance
(RIC: LKOH.MM, BB: LKOH RM)



Lukoil (LKOH.MM)

The value's there, but where's the catalyst?

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption change increases our DCF by c20%, but our overall weighted TP rises a smaller 9% to $88/share. Including an expected 5% dividend yield, this gives us an expected total return of 47%.

- **Recommendation maintained at Buy: :** We maintain Lukoil at a Buy, and see significant upside potential in the stock on a medium-term view. However, it is not one of our Best Ideas given that we struggle to see company-specific catalysts over the upcoming 3 months (the time horizon of a Best Idea) that could re-rate the stock. In particular, Lukoil has issues with the 3 key Russian discount drivers introduced with this note, in particular growth, which will take time to be answered.

- **Lukoil and the 3 discounts**

  – **Growth:** Lukoil is facing a problem typical for large, mature oil producers. Lacking Rosneft's large, young fields and huge portfolio of offshore licenses, Lukoil is scrambling to offset declines at ageing core fields. Lukoil has made progress in recent years, first stabilizing West Siberian production and then, in late 2012, winning the 1.4bn bbl Imilorskoye field, one of the last large on-shore greenfields. An early adapter of US shale technology to West Siberian conventional plays, Lukoil may benefit from the new tight oil tax breaks, although management is sanguine about the opportunity in its Bazhenov shale exposure. Altogether, we think the market is hesitant to credit the company with anything more than stagnant production levels until proven wrong.

  – **Political risk:** Lukoil benefits modestly from the de-risking in proposed gas tax regime (it has dry gas assets, but they are relatively small against its liquids, refining, and international gas business). It also has limited exposure to the proposed offshore tax regime: while its Caspian operations get a break, but no access to Russia's continental shelf in spite of sustained lobbying by its key shareholders. It has no visible exposure to the likely LNG export liberalization.

  – **Corporate governance:** The market is still waiting for Lukoil to move to its long-promised 30% or 40% dividend payout, although we give management positive marks for finally breaking out of a decade-long 15%-20% range with its latest, c22% payout. Elsewhere, the company's emphasis on its Iraq venture (which has a positive but very modest NPV) and a less-than-stellar track record of investing in European refining engender some skepticism about the efficacy of its reinvestment program. The exception is the apparent return on capital from its upgrade of its Russian refineries, which seems top-notch.

Lukoil (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	133,650.0	139,171.0	138,161.0	130,275.4	125,927.1
Net Income ($M)	10,357.0	11,004.0	10,803.5	8,969.5	7,183.2
Diluted EPS ($)	13.72	14.58	14.31	11.88	9.52
Diluted EPS (Old) ($)	13.72	14.58	14.58	13.46	10.51
PE (x)	4.5	4.2	4.3	5.2	6.5
EV/EBITDA (x)	2.7	2.4	2.5	2.7	3.0
DPS ($)	2.55	2.42	2.80	3.09	2.53
Net Div Yield (%)	4.1	3.9	4.5	5.0	4.1

Company Focus

■ Estimate Change

Buy	1
Price (13 Sep 13)	US$130.10
Target price	US$163.00
Expected share price return	25.3%
Expected dividend yield	2.1%
Expected total return	**27.4%**
Market Cap	US$39,395M

Price Performance
(RIC: NVTKq.L, BB: NVTK LI)

Novatek OAO (NVTKq.L)

A new growth worry

- **Oil price assumption boosts DCF, Target Price, but less than peers:** Our oil price assumption increase boosts Novatek's DCF by 4% – but there is no change to our $163/share TP – smaller than the increases seen for its blue-chip peers due to the company's relatively heavy exposure to the Russian domestic gas market and the negative effects of lower tariffs growth. Including an expected 2.1% dividend yield, this gives us an expected total return of 27%.

- **Recommendation maintained at Buy:** We maintain Novatek at a Buy, but note that with the other Russian oil & gas names generally benefitting more from the change, and with the stock having had a good run since mid-summer, it has moved down our priority list. We still see a very good upside to our long-term DCF, but think with questions continuing to swirl around Russian gas tariffs, the stock will likely have to grow into that valuation over time.

- **Novatek and the 3 discounts**

  – **Growth:** Novatek has long benefitted from rapidly growing domestic gas tariffs. Indeed, for years expected tariff growth, not production growth, was the key driver of earnings gains in our model. That has changed in the course of 2013, first with a strongly-signaled intent to slow down tariff growth in 2014 to an inflation-level 6%-7%, and in recent days with a sudden push by parts of the government to zero out growth entirely for next year. We have no insight at this time as to what 2015 and subsequent increases might look be, and we think the government itself probably doesn't know yet. Otherwise, we see volume growth for gas and liquids at 7%-10% pa for the next few years, and before the Yamal LNG project begins production in 2017 or so.

  – **Political risk:** Despite not being a state-owned company, Novatek has one of the lowest corporate governance risk scores in its sector due to the stellar connections of its two main shareholders and as evidenced by a steady string of policy wins for independents over Gazprom over the years. We do not see that risk score as unstable, but note that, as Novatek has grown, its ability to parley this strength into higher growth has begun to reach its natural limits.

  – **Corporate governance:** We think Novatek leads the Russian oil & gas universe in terms of alignment of interests between core and minority shareholders. Management has long kept close tabs on the stock price. As we think the clearest path to value-maximization for insiders is to grow the company into its full potential and realize that via equity prices, we don't see this changing any time soon.

Novatek OAO (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	5,955.7	6,793.7	8,393.4	8,927.6	9,632.5
Net Income ($M)	2,346.2	2,236.7	2,823.7	2,774.4	2,962.4
Diluted EPS ($)	7.74	7.38	9.31	9.15	9.77
Diluted EPS (Old) ($)	7.74	7.38	9.63	10.01	10.66
PE (x)	16.8	17.6	14.0	14.2	13.3
EV/EBITDA (x)	13.5	12.1	9.1	9.1	8.4
DPS ($)	2.04	2.21	2.79	2.74	2.93
Net Div Yield (%)	1.6	1.7	2.1	2.1	2.3

Company Focus

- Target Price Change
- Estimate Change

Buy	**1**
Price (13 Sep 13)	US$7.95
Target price	US$10.00
from US$9.20	
Expected share price return	25.8%
Expected dividend yield	3.6%
Expected total return	**29.4%**
Market Cap	US$84,263M

Price Performance
(RIC: ROSN.MM, BB: ROSN RM)

Rosneft (ROSN.MM)

Waiting for the offshore catalyst

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption increase boosts Rosneft's DCF by 12% and our overall weighted TP a smaller 9% to $10.0/share. Including an expected 3.6% dividend yield, this gives us an expected total return of 29%.

- **Recommendation maintained at Buy:** We maintain Rosneft at a Buy, and as with Novatek see a substantial upside to our DCF value (+33%) but see the stock as being constrained by near-term multiples, with an average of a -5% return to our EV/EBITDA and P/E-based price indicators. We think the stock may have trouble outperforming the peer group until a catalyst occurs for the company's offshore opportunity, where the large upside resides (on a conservative basis, it accounts for $0.99/sh of our $10.0/share TP, without which the stock would look much less attractive.

- **Rosneft and the 3 discounts**

  – **Growth:** For Rosneft earnings growth has two primary sources – the completion of its ambitious refinery upgrade project in 2H15, and its huge portfolio of offshore exploration licenses, which it is developing under a number of JVs with international majors, primarily ExxonMobil, Statoil, and ENI. One catalyst could be the passage of Russia's new offshore tax regime this fall, which mostly concerns Rosneft. However, as that has been pretty well signaled, as a catalyst that it may not have an extraordinary effect. More promising are the two exploratory wells being drilled in the Kara and Black Seas next summer, which could generate positive newsflow by YE2014.

  – **Political risk:** As a state-owned company captained by arguably one of Russia's most influential politicians – Igor Sechin – Rosneft has excellent political risk control. Additionally, the passage of the offshore tax regime and LNG liberalization – which we fully expect this fall – as well as the already-passed tight oil tax breaks, removes significant room for policy uncertainty.

  – **Corporate governance:** While still a Russian state-owned company, the arrival of Mr. Sechin in May of 2012 marked an improvement in Rosneft's corporate governance score. In particular, he immediately moved to have the company begin paying 25% of IFRS, which required a supplemental dividend that exceeded the initial one. He also reopened dialogue with investors, taking top management London twice – so far – for investors days.

Rosneft (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	92,356.4	99,117.6	136,950.5	150,175.8	144,603.7
Net Income ($M)	11,009.4	12,384.9	12,131.7	10,753.5	7,766.1
Diluted EPS ($)	1.15	1.23	1.14	1.01	0.73
Diluted EPS (Old) ($)	1.15	1.23	1.26	1.12	0.94
PE (x)	6.9	6.5	6.9	7.8	10.8
EV/EBITDA (x)	4.5	5.0	4.6	5.6	6.2
DPS ($)	0.26	0.27	0.26	0.23	0.16
Net Div Yield (%)	3.2	3.4	3.3	2.9	2.0

Company Focus

- Target Price Change
- Estimate Change

Buy	**1**
Price (13 Sep 13)	US$0.83
Target price	US$1.24
from US$1.17	
Expected share price return	49.2%
Expected dividend yield	2.6%
Expected total return	**51.8%**
Market Cap	US$35,105M

Price Performance
(RIC: SNGS.MM, BB: SNGS RM)

Surgutneftegaz (SNGS.MM)

Commons – Value, but little in the way of catalysts

- **Oil price assumption boosts DCF, Target Price:** Our oil price assumption increase, combined with eliminating our haircut on the company's cash pile, boosts SurgutNG's DCF by +16%, while our overall weighted TP a smaller +6% to $1.24/share. Including an expected 2.6% dividend yield, this gives us an expected total return (ETR) of 52%.

- **Recommendation maintained at Buy:** We maintain SurgutNG commons at a Buy, given that total substantial ETR. That being said, value is about the only thing recommending this stock. If the Russian oil & gas sector re-rates – which we argue it should – then SurgutNG commons will likely prove to be a good absolute investment. However, within Russian oil & gas names, we'd prefer several other Buy-rated stocks, especially Gazprom and, interestingly, SurgutNG's own preferred stock (see the next page), which has a significantly superior call on SurgutNG's cash flows, including guarantees in the company's charter that the pref will both: a) receive a minimum 40% payout ratio; and b) can never be paid a dividend smaller than that paid to the common.

- **SurgutNG commons and the 3 discounts**

  – **Growth:** SurgutNG's production is expected to remain stable at around the current 1.3mmbpd for the next 5 years. An aggressive driller (SurgutNG accounts for about 1/3 of Russia's annual drilling total) SurgutNG may be more ready than most to take advantage of the recently-passed tight oil tax breaks in order to sustain production in West Siberia, although we are not able to say if it will lead to outright production growth for the company.

  – **Political risk:** SurgutNG is apparently well-connected politically, but doesn't benefit from the three main legislative gains we foresee being achieved in autumn, having no exposure to dry gas production, the Russian offshore, or any LNG projects.

  – **Corporate governance:** SurgutNG has long been at the bottom of the corporate governance league table in Russian oil & gas, with a management team that is proudly indifferent to investor opinion and which refuses to release some basic and critical information – the whereabouts and status of the previously large treasury share position (>40% of commons) as well as oil & gas reserve estimates. However, earlier this year the company did improve transparency significantly with the long-awaited release of international accounts, albeit this was prompted by Russian law rather than any desire on the part of management to increase its transparency.

Surgutneftegaz (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	25,635.2	26,263.1	24,844.9	25,084.3	23,947.5
Net Income ($M)	7,613.8	4,649.4	8,449.3	6,232.3	5,710.2
Diluted EPS ($)	0.21	0.13	0.24	0.17	0.16
Diluted EPS (Old) ($)	0.21	0.13	0.23	0.18	0.14
PE (x)	3.9	6.4	3.5	4.8	5.2
EV/EBITDA (x)	0.8	0.5	0.2	0.0	-0.2
DPS ($)	0.02	0.02	0.02	0.02	0.02
Net Div Yield (%)	2.5	1.9	2.6	2.3	2.1

Company Focus

■ Target Price Change

Buy	1
Price (13 Sep 13)	US$0.70
Target price	US$1.18
from US$1.11	
Expected share price return	68.2%
Expected dividend yield	11.5%
Expected total return	**79.7%**
Market Cap	US$35,105M

Price Performance
(RIC: SNGS_p.MM, BB: SNGSP RM)

Surgutneftegaz(pref) (SNGS_P.MM)

A guaranteed 40% payout makes all the difference

- **Oil price assumption boosts DCF, Target Price:** We maintain our recently-introduced 5% discount target to the commons, as we think the recent introduction of T+2 trading on MICEX will, with time, open up the pref to a new class of investors previously effectively barred from owning the stock. As our oil price assumption increase boosted SurgutNG's common's TP by +6%, it likewise increased our preferred TP by the same amount to $1.18. Including an expected 11.5% dividend yield, this gives us an expected total return (ETR) of 80%.

- **Recommendation maintained at Buy, Best Idea:** We maintain SurgutNG prefs at a Buy, given a very attractive 1-year dividend yield and overall large upside. We maintain the stock as one of our two Best Ideas in Russian oil & gas alongside Gazprom. To reiterate our investment thesis, we see the preferred shares as having a significantly superior call on SurgutNG's cash flows relative to the common, including guarantees imbedded in the company's charter that the pref will both: a) receive a minimum 40% payout ratio; and b) can never be paid a dividend smaller than that paid to the common. Additionally, with the total market cap (ords + prefs) roughly equal to the company's $32bn cash position, SurgutNG is in general very defensive (Figure 14).

- **SurgutNG commons and the 3 discounts:**

  – **Growth:** SurgutNG's production is expected to remain stable at around the current 1.3mmbpd for the next 5 years. An aggressive driller, SurgutNG may be more ready than most to take advantage of the recently-passed tight oil tax breaks in order to sustain production in West Siberia, although we are not able to say if it will lead to outright production growth for the company.

  – **Political risk:** SurgutNG is apparently well-connected politically, but doesn't benefit from the three main legislative gains we foresee being achieved in autumn, having no exposure to dry gas production, the Russian offshore, or any LNG projects.

  – **Corporate governance:** SurgutNG has long been at the bottom of the corporate governance league table in Russian oil & gas (see the common discussion on the previous page for details). However, we think the preferred share's guaranteed 40% minimum payout actually significantly reduces the importance of the company's other corporate governance shortcomings.

Surgutneftegaz(pref) (USD)

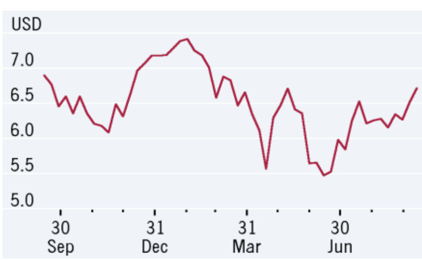
Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	25,635.2	26,263.1	24,844.9	25,084.3	23,947.5
Net Income ($M)	7,613.8	4,649.4	8,449.3	6,232.3	5,710.2
Diluted EPS ($)	0.21	0.13	0.24	0.17	0.16
Diluted EPS (Old) ($)	0.21	0.13	0.23	0.18	0.14
PE (x)	3.3	5.4	3.0	4.0	4.4
EV/EBITDA (x)	0.8	0.5	0.2	0.0	-0.2
DPS ($)	0.07	0.05	0.08	0.06	0.06
Net Div Yield (%)	10.4	6.8	11.6	9.0	8.1

Company Focus

- **Estimate Change**

Neutral	**2**
Price (13 Sep 13)	US$6.76
Target price	-
Expected share price return	-
Expected dividend yield	-
Expected total return	**-**
Market Cap	US$15,218M

Price Performance
(RIC: TATN.MM, BB: TATN RM)



Tatneft (TATN.MM)

Small model adjustments – Watch ETF flows

- **Still Neutral** — We continue to have a Neutral recommendation on Tatneft without a target price, on both common and preferred shares. Changes in our oil price, ruble, and inflation assumptions have had some modest impact on our model, but not enough to change our basic view.
- **Key issue we see? ETF dominance of trading activity** — We think Tatneft is overrepresented in certain indexes used by Russia-focused Exchange Traded Funds, meaning that when those funds get inflows, their program buying is heavy for Tatneft relative to that stocks typical daily trading activity. This can lead to unexplained out-performance when Russian ETFs are attracting new funds, and under-performance when they experience outflows. As fund flows are fundamentally unpredictable – or at least are outside of our competence as oil & gas analysts – we are more hesitant to make investment recommendations on Tatneft based on financial and operating fundamentals.

Tatneft (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	20,931.9	20,176.3	19,493.9	18,390.5	17,223.4
Net Income ($M)	2,085.1	2,332.4	2,015.8	1,934.1	2,149.9
Diluted EPS ($)	0.98	1.10	0.95	0.91	1.01
Diluted EPS (Old) ($)	0.98	1.10	1.02	0.99	1.08
PE (x)	6.9	6.2	7.1	7.4	6.7
EV/EBITDA (x)	na	4.8	5.0	4.9	4.4
DPS ($)	0.24	0.28	0.24	0.21	0.23
Net Div Yield (%)	3.6	4.1	3.5	3.1	3.5

Company Focus

Tatneft(pref) (TATN_p.MM)

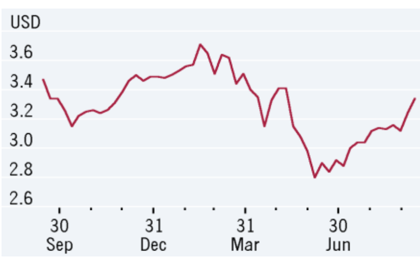
Small model adjustments – Watch ETF flows

- **Still Neutral** — We continue to have a Neutral, recommendation on Tatneft without a target price, both common and preferred shares. Changes in our oil price, ruble, and inflation assumptions have had some modest impact on our model, but not enough to change our basic view.

- **Key issue we see? ETF dominance of trading activity** — We think Tatneft is overrepresented in certain indexes used by Russia-focused Exchange Traded Funds, meaning that when those funds get inflows, their program buying is heavy for Tatneft relative to that stocks typical daily trading activity. This can lead to unexplained out-performance when Russian ETFs are attracting new funds, and under-performance when they experience outflows. As fund flows are fundamentally unpredictable – or at least are outside of our competence as oil & gas analysts – we are more hesitant to make investment recommendations on Tatneft based on financial and operating fundamentals.

Neutral	**2**
Price (13 Sep 13)	US$3.36
Target price	-
Expected share price return	-
Expected dividend yield	-
Expected total return	**-**
Market Cap	US$15,218M

Price Performance
(RIC: TATN_p.MM, BB: TATNP RM)



Tatneft(pref) (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales ($M)	20,931.9	20,176.3	19,493.9	18,390.5	17,223.4
Net Income ($M)	2,085.1	2,332.4	2,015.8	1,934.1	2,149.9
Diluted EPS ($)	0.98	1.10	0.95	0.91	1.01
Diluted EPS (Old) ($)	0.98	1.10	1.02	0.99	1.08
PE (x)	3.4	3.1	3.5	3.7	3.3
EV/EBITDA (x)	na	4.8	5.0	4.9	4.4
DPS ($)	0.24	0.28	0.24	0.21	0.23
Net Div Yield (%)	7.2	8.2	7.1	6.3	7.0

Alliance Oil

Company description

Alliance Oil is a vertically integrated oil company with upstream operations in Tomsk, Timano-Pechora and Volga-Urals, and small exposure to Kazakhstan. It operates the Khabarovsk oil refinery with annual capacity of 5mmtpa. Alliance Oil is listed in Stockholm, though its core business operations are in the Russian Federation.

Investment strategy

We rate Alliance Oil common shares as Neutral/High Risk. In our view, the recent positive developments (integrity of the Kolvinskoye field reserves estimate, expansion in gas business, completion of the upstream JV with Repsol) as well as the expected improvement of profitability and FCF in 2014E fueled by downstream modernization tailwinds are well balanced with the company-and industry-specific risks (further leg of tax reform unfavorable for Alliance Oil and risks associated with the Far East refined products market post modernization).

Valuation

We set our target price for Alliance Oil at SEK60.2, which is derived as a blend of three methodologies: 1) DCF valuation of SEK75.1 based on a WACC of 10.1% and terminal growth rate of 3.0%, with a 50% weighting, 2) near-term (2013E) multiple valuations (25% weighting each) including implied valuations of SEK40.3 on a P/E basis and SEK50.2 on an EV/EBITDA basis.

Risks

We assign Alliance Oil a High Risk rating, based on company-and industry-specific considerations. The key risks to our investment case include on the downside: 1) a weaker-than-expected oil price , 2) a stronger-than-expected Ruble vs. US$, 3) weaker-than-expected oil production, 4) delays to the modernization of Khabarovsk refinery, 5) unfavorable changes in taxation of the oil sector, 6) reduction in domestic refined product prices. Upside risks include: 1) takeover by a Russian oil major at a premium to market price, 2) positive exploration results in the Timano-Pechora region.

Bashneft

Company description

Bashneft is the seventh-largest integrated oil producer in Russia. Accounting for c.3% of Russia's total crude output, Bashneft develops the very mature reserve base located in the Bashkortostan region of Russia. At the same time, after Sistema took over the company back in April 2009, Bashneft managed to demonstrate outstanding production results and win the license for the Trebs and Titov project, which is set to become the most important production growth driver for the company going forward.

Investment strategy

We rate Bashneft a Buy. Bashneft is one of the rare examples in the Russian oil and gas universe of a company run exclusively for its shareholders, equally benefitting core shareholder Sistema and the minorities. With the increasingly likely resumption of generous dividends and elimination of the Sistema-Invest circular ownership, the pre-IPO optimisation process is arguably occurring. With a number of potential catalysts remaining to boost Bashneft's shareholder value, we think it is not late get involved.

Valuation

We derive our Bashneft target price of $79.2 as a blend of three methodologies: 1) DCF valuation of $82.5 based on a WACC of 10.1% and terminal growth of 3.5% with a 50% weighting, 2) Near-term (2013E) multiple valuations (25% weighting each) include an implied valuation of $75.9/share on a P/E basis and $76.1/share on an EV/EBITDA basis.

Risks

Bashneft’s primary risks are the same ones facing other Russian oil companies: oil price and ruble volatility, oilfield inflation, and a heavy tax burden. We also highlight the risk of a faster-than-expected production decline at the legacy asset base. Additionally, there is a risk that Bashneft investors could face unfavorable treatment of minorities by the controlling shareholder Sistema. These risks could impede the share price from reaching our target price.

Gazprom

Company description

Gazprom is the world's largest gas company, with a core business producing, transporting and selling natural gas. Gazprom is the world leader by gas reserves, gas production and the size of its high-pressure gas transport system. The company is majority owned by the Russian government.

Investment strategy

We rate Gazprom's stock 1-Buy. With Gazprom having largely resolved gas taxation issues, the key issues facing the company today are contract pricing negotiations with Ukraine and the European supply/demand balance. The latter is now breaking decidedly in Gazprom’s favor, and the equity market is just beginning to realise that, we think. We still nominally expect Ukrainian prices to be sharply cut in 2013 to bring them into line with European netback parity, although the negotiations have dragged on for far longer than we thought possible.

Valuation

We derive our Gazprom target price of $7.5 based on: 1) a DCF valuation of $7.9, using a WACC of 10.3% and terminal growth of 3.0% (50% weight); 2) 2013E EV/EBITDA target price of $6.8 based on a target multiple of 3.6x (25%); and 3) 2013E P/E target price of $7.3 based on a target multiple of 5.4x (25%).

Risks

Among the downside risks which could impede the shares from achieving our target price, we highlight potentially lower European gas export prices, faster-than-expected market share losses domestically as independent producers gain traction; a potential a slowdown in domestic gas price growth; and, given the significant levels of capex for bringing new fields on stream to replace declining production at core West Siberian fields, execution risk.

Gazpromneft

Company description

Gazpromneft (formerly Sibneft) is the fourth-largest integrated producer in Russia, operating from Western Siberia. The company also operates a refinery in Omsk. In 2005, Gazprom acquired 75% of Sibneft, later raised to c95%, and intends to use the unit as its platform for the oil business. Gazpromneft also owns a 50% stake in Slavneft jointly with Rosneft.

Investment strategy

We rate Gazpromneft stock a Buy. Gazpromneft offers one of the best growth opportunities in the Russian oil and gas space, in our view, aiming to increase hydrocarbon production by 67% in 2020 as compared with 2012 and growing at a CAGR of 7%. We argue that Gazpromneft’s outstanding growth prospects, coupled with solid dividends yielding more than 5%, make it one of the most attractive oil and gas stocks in Russia.

Valuation

We derive our Gazpromneft target price of $6.31 based on: 1) DCF valuation of $6.90 based on a WACC of 9.6% and terminal growth of 3.0% - with a 50% weighting, 2) Near-term (2013E) multiple valuations (25% weighting each) include an implied target price of $5.54/share on a P/E basis and $5.90/share on an EV/EBITDA basis.

Risks

Gazpromneft’s primary risks are the same ones facing other Russian oil companies: oil price and ruble volatility, oilfield inflation, and a heavy tax burden. Additionally, there is a risk that Gazpromneft investors could face unfavourable treatment of minorities by the controlling shareholder Gazprom, and Gazprom's less efficient management culture could negatively impact earnings in the medium to long term if it begins to displace the disciplined legacy Sibneft culture. These risks could impede the share price from reaching our target price.

Lukoil

Company description

Lukoil is one of the largest vertically-integrated energy producers in the, world with a well-diversified asset base. Producing over 2mmboepd on a consolidated basis, Lukoil is Russia's second-largest oil producer and is the country's second-largest refiner, as well.

Investment strategy

Fundamentally, we see the Russian upstream oil segment and Lukoil in particular as being constrained by a high tax burden and by rapidly ageing West Siberian fields. Downstream is rather profitable and the company should see substantial earnings gains from its refinery upgrade programme. We also see Lukoil as providing solid exposure to the developing Russian independent gas industry among Russian oil majors. Iraq will absorb cash in 2013E, but will begin returning it in 2014E, meaning that, after contracting to around zero in 2013E, FCF generation should bounce back to around $5bn/yr, on our estimates. We like Lukoil at these levels, rating it a 1-Buy.

Valuation

We set our target price at $88, which is a blend of our DCF value ($98, 50% weighting, which assumes WACC of 10.6%, long-term growth of 3.0%), and a return to adjusted historical, 12-month mean P/E and EV/EBITDA ratios of 5.2x and 3.5x, respectively, which indicate valuations of $75/ADR and $82/ADR, respectively, each of which we weight at 25%.

Risks

The following risks may impede the achievement of our target price for Lukoil: Volatility in international crude prices; cost inflation; capex overruns; and changes in legislation, tax or otherwise, either in Russia or other countries where LUKoil has interests.

Novatek OAO

Company description

Novatek is the largest independent gas producer in Russia, selling 59bcm in 2012. The company sells all of its gas in the domestic market, both delivering gas directly to end customers via Gazprom's gas transportation pipeline and, increasingly rarely, by sales to traders at the wellhead. Novatek also produces and sells substantial amounts of stable gas condensate and other liquids, processing and exporting the bulk of them via the company's own plants and port facilities, and is increasing its processing and refining capacity for natural gas liquids.

Investment strategy

Novatek is a growth play, in our view, with gas output expected to rise to c75bcm in 2017E from a net 59bcm in 2012, including increased production from equity stakes in Sibneftegas and SeverEnergia, but excluding the effect on operating numbers from Yamal LNG. The latter project will allow Novatek to export Russian gas to overseas markets, but first production will come only in 2017 or so. We believe the growth potential is not yet fully priced into the stock, in spite of seemingly still-lofty multiples. We rate the stock a 1-Buy.

Valuation

We derive our Novatek target price of $163/ADR based on: 1) a 50% weighting to a DCF value of $189/share (3% terminal growth rate, WACC of 8.3%); 2) 25% weighting to 2013E target P/E multiple of 14.8x ($138/share); and 3) 25% weighting to a 11.4x target 2013E EV/EBITDA multiple ($141/ADR).

Risks

Among the key risks that could cause the stock to deviate from our target price, we highlight the following: 1) slower pace of domestic gas tariff hikes as approved by the government; 2) Potential further delays in its key Yamal LNG project; 3) Standard oil & gas company risks relating to oil price and exchange rate volatility.

Rosneft

Company description

Rosneft is Russia's largest vertically-integrated oil company and, after the completion of the TNK-BP acquisition, the world's largest traded oil producer. Rosneft is one of the most active developers of the Russian continental shelf and Eastern Siberia.

Investment strategy

Rosneft provides exposure to vast natural resources, strong operational growth and considerable exploration upside, which comes from an extensive undeveloped portfolio, particularly in Russia's offshore and, to a lesser extent, in East Siberia. Rosneft's upstream prospects are materially better than those of other major Russian oil companies, with production growth still to come at its key Vankor cluster of fields, numerous promising East Siberian exploration blocks, and long-term from its recently announced cooperation agreements with ExxonMobil, ENI, and Statoil. The company's $25bn refinery modernisation programme, while ambitious, appears to us set to earn returns well in excess of its cost of capital. We rate Rosneft's stock a 1-Buy.

Valuation

Our target price for Rosneft is $10.0, which is the sum of our base case valuation of $9.0 plus $0.99 to account for the value of the offshore opportunity, which we do not include explicitly in our DCF. Our base case valuation is a mix of long-term DCF and near-term multiples. Our DCF value of $10.5/share (50% weighting) reflects the company's access to relatively good investment opportunities in legacy regions as well as substantial growth opportunities on Russia's continental shelf (offshore) and in the gas business. We use a WACC of 8.8%, a long-term growth rate of 3.0% and beta of 1.0. Our near-term (2013E) multiple valuations (25% weighting each) include an implied price of $7.0/share on a P/E basis and a more attractive $8.1/share on an EV/EBITDA basis.

Risks

Although state-owned, Rosneft faces the typical oil price risks of any other Russian oil company. Our target price could be exceeded were Rosneft to be the material beneficiary of any further consolidation of Russian hydrocarbon assets sponsored by the state. The government could change its approach to the company in terms of favorable taxation regime and favorable transportation tariffs for eastbound routes.

Surgutneftegaz

Company description

Surgutneftegaz is the third-largest vertically-integrated producer in Russia, with its upstream asset base in Western Siberia. Kirishi (near St Petersburg) is its only refinery. As such, it has less downstream exposure relative to its production level than do most of its domestic peers. Shareholder structure opaque and is distorted by a significant treasury position.

Investment strategy

Operationally, Surgutneftegaz provides limited volume growth now, but a long-running downstream upgrade project now completing should improve profitability there. Poor corporate governance and transparency are offset by the benefits of the largely dollar-denominated cash pile, which decreases the company's leverage to oil prices and changes in ruble strength relative to its Russian peers. Corporate governance improved noticeably on April 30, 2013 when the company finally began publishing IFRS results. We rate both the Surgutneftegaz common share and its pref share Buy, but note the latter has a dividend kicker if the ruble should weaken due to the effect on net income of currency gains. The prefs should also benefit from the opening of Russia's central depository and the move to T+2 trading in September 2013, which should narrow the pref/common discount as it becomes investable to a wider group of investors.

Valuation

Our $1.24 target price for Surgutneftegaz common shares is based on: 1) DCF valuation of $1.24 with a 14.2% WACC and 3.0% terminal growth rate; and 2) Near-term (2013E) multiple valuations (25% weighting each) of $1.38/share on a P/E basis and $1.12/share on an EV/EBITDA basis.

Risks

SurgutNG is exposed to all of the same industry-specific risks as its peers. Corporate governance and transparency issues are an issue, but by and large are not as important as the broader industry risks of oil prices and moves in the RUB/USD exchange rate, and to some extent are offset by the positive effects of the large, dollar-denominated cash pile. These risks could impede the share price from reaching our target price.

Surgutneftegaz(pref)

Company description

Surgutneftegaz is the third-largest vertically-integrated producer in Russia, with its upstream asset base in Western Siberia. Kirishi (near St Petersburg) is its only refinery. As such, it has less downstream exposure relative to its production level than do most of its domestic peers. Shareholder structure opaque and is distorted by a significant treasury position.

Investment strategy

Operationally, Surgutneftegaz provides limited volume growth now, but a long-running downstream upgrade project now completing should improve profitability there. Poor corporate governance and transparency are offset by the benefits of the

largely dollar-denominated cash pile, which decreases the company's leverage to oil prices and changes in ruble strength relative to its Russian peers. Corporate governance improved noticeably on April 30, 2013 when the company finally began publishing IFRS results. We rate both the Surgutneftegaz common share and its pref share Buy, but note the latter has a dividend kicker if the ruble should weaken due to the effect on net income from currency gains. The prefs should also benefit from the opening of Russia's central depository and the move to T+2 trading in September 2013, which should narrow the pref/common discount as it becomes investable to a wider group of investors.

Valuation

Our $1.18 target price for SurgutNG's preferred shares is achieved by applying a 5% discount (the average discount seen when DR liquidity was far higher than today) to our $1.24/share common TP. We need to add to that, however, the $0.081 dividend we expect the preferred stock to pay out in 2014, with an ex-div date likely to occur in mid-May.

Risks

SurgutNG is exposed to all of the same industry-specific risks as its peers. Corporate governance and transparency issues are an issue, but by and large are not as important as the broader industry risks of oil prices and moves in the RUB/USD exchange rate, and to some extent are offset by the positive effects of the large, dollar-denominated cash pile. These risks could impede the share price from reaching our target price.

Tatneft

Company description

Tatneft is the fifth-largest producer in Russia; some 60% of output comes from fields in operation for over 53 years, hence it suffers from higher opex and poor crude quality. Tatneft until recently had no refining capacity, but has been reportedly having problems bringing on-line its brand-new Nizhnekamsk plant. The local government owns 34% and has a material influence on the management.

Investment strategy

We rate Tatneft Neutral. Fundamentally, we argue that Tatneft's performance is unimpressive, with flat production and higher-than-average operating costs, which are a function of its mature asset base. However, low refining exposure implies higher leverage to the oil price, making Tatneft one of the biggest beneficiaries in a bull market which is amplified by its hefty weights in various stock market indexes.

Valuation

This company has a Neutral rating. We have not assigned a target price and therefore no valuation methodology is applicable.

Risks

Tatneft is exposed to all of the same industry-specific risks as its peers. Corporate governance and transparency issues are an issue, but by and large are not as important as the broader industry risks of oil prices and moves in the RUB/USD exchange rate.

Tatneft(pref)

Company description

Tatneft is the fifth-largest producer in Russia; some 60% of output comes from fields in operation for over 53 years, hence it suffers from higher opex and poor crude quality. Tatneft until recently had no refining capacity, but has been reportedly having problems bringing on-line its brand-new Nizhnekamsk plant. The local government owns 34% and has a material influence on the management.

Investment strategy

Fundamentally, Tatneft's performance is unimpressive, with flat production and higher-than-average operating costs, which are a function of its mature asset base. However, low refining exposure implies higher leverage to the oil price, making Tatneft one of the biggest beneficiaries in bull market which is amplified by its hefty weights in various stock market indexes.

Valuation

This company has a Neutral rating. We have not assigned a target price and therefore no valuation methodology is applicable.

Risks

Tatneft is exposed to all of the same industry-specific risks as its peers. Corporate governance and transparency issues are an issue, but by and large are not as important as the broader industry risks of oil prices and moves in the RUB/USD exchange rate.

Appendix A-1

Analyst Certification

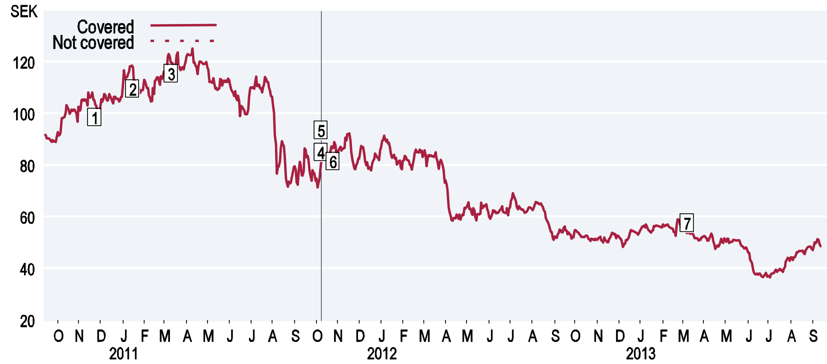
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Alliance Oil (AOILsdb.ST)

Ratings and Target Price History
Fundamental Research

Analyst: Alexander Bespalov, CFA
Covered since August 31 2012



	Date	Rating	Target Price	Closing Price
1	23-Nov-10	*2H	*130.00	105.20
2	14-Jan-11	*1H	*155.00	118.40
3	10-Mar-11	1H	*151.00	119.70

	Date	Rating	Target Price	Closing Price
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*1	151.00	78.20
6	25-Oct-11	1	*107.00	86.40

	Date	Rating	Target Price	Closing Price
7	7-Mar-13	*2	*62.70	53.60

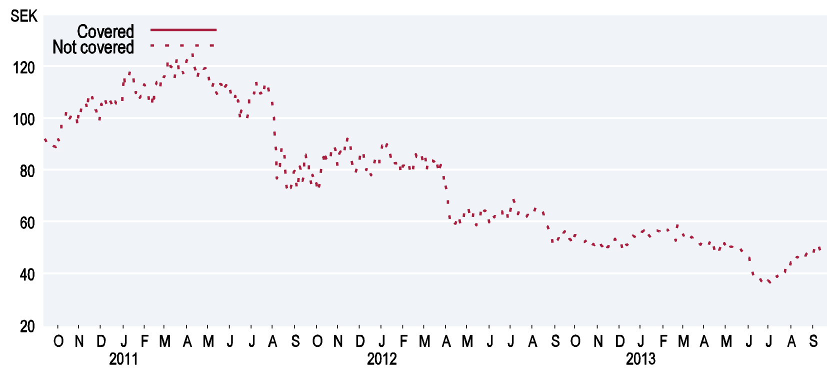
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Alliance Oil (AOILsdb.ST)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Alexander Bespalov, CFA
Covered since August 31 2012



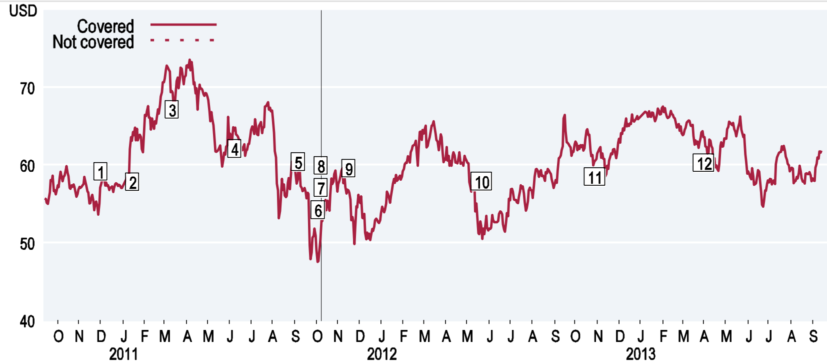
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Lukoil (LKOH.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 8 2011



	Date	Rating	Target Price	Closing Price
1	1-Dec-10	1L	*74.00	57.07
2	14-Jan-11	1L	*84.00	63.09
3	11-Mar-11	1L	*81.00	69.45
4	8-Jun-11	*1M	*76.30	64.43
5	6-Sep-11	*2M	*63.90	58.08
6	4-Oct-11	*1M	63.90	47.48
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	63.90	50.36
9	16-Nov-11	1	*70.60	56.67
10	22-May-12	1	*66.30	52.16
11	29-Oct-12	1	*76.60	60.44
12	1-Apr-13	1	*81.00	63.53

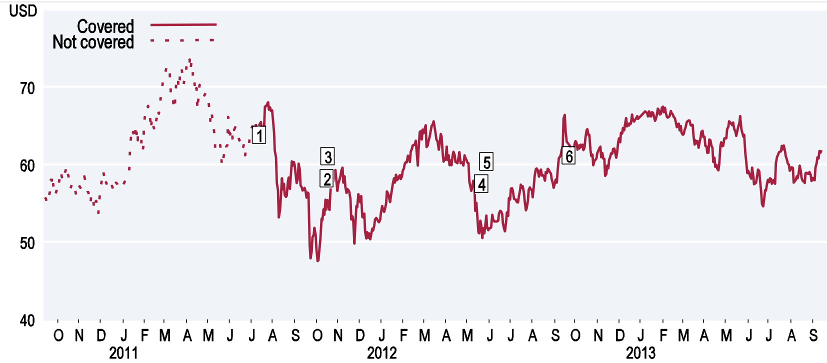
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Lukoil (LKOH.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 8 2011



	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD LP	-	64.99
2	17-Oct-11	*REM LP	-	54.13
3	18-Oct-11	*ADD MP	-	55.38
4	22-May-12	*REM MP	-	52.16
5	29-May-12	*ADD MP	-	53.40
6	21-Sep-12	*REM MP	-	62.61

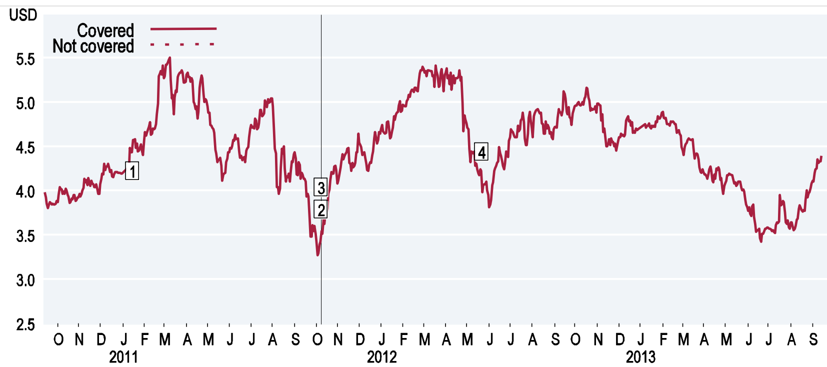
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Gazpromneft (SIBN.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 30 2011



	Date	Rating	Target Price	Closing Price
1	14-Jan-11	1M	*6.30	4.43
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*1	6.30	3.42
4	22-May-12	1	*5.77	4.22

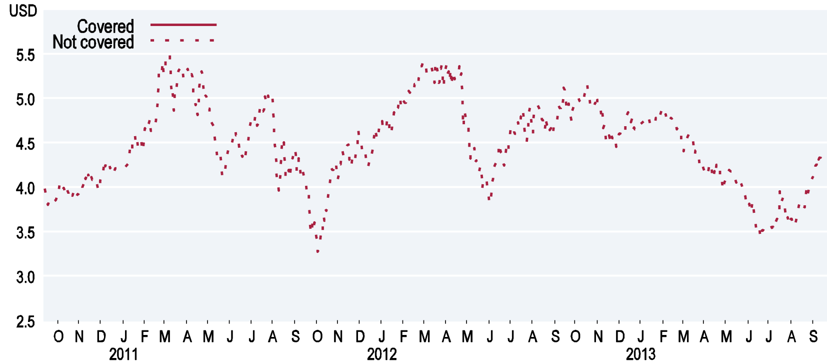
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Gazpromneft (SIBN.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 30 2011



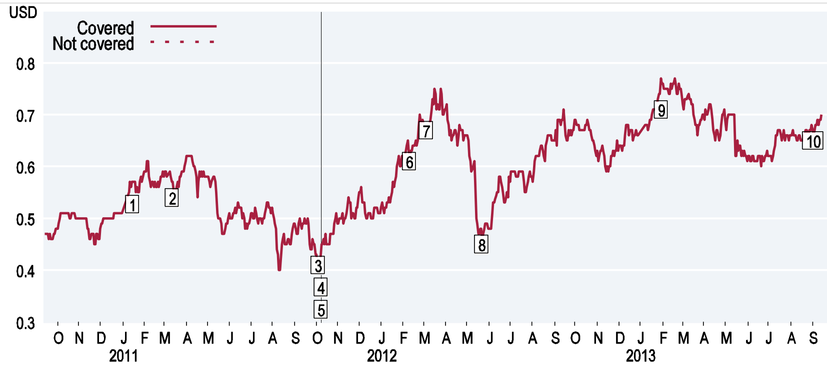
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Surgutneftegaz(pref) (SNGS_p.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 30 2011



	Date	Rating	Target Price	Closing Price
1	14-Jan-11	1H	*0.63	0.57
2	11-Mar-11	1H	*0.67	0.57
3	4-Oct-11	*1M	0.67	0.41
4	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	*1	0.67	0.42
6	9-Feb-12	1	*0.71	0.63
7	5-Mar-12	1	*0.96	0.68
8	22-May-12	1	*0.88	0.48

	Date	Rating	Target Price	Closing Price
9	30-Jan-13	1	*0.99	0.77
10	2-Sep-13	1	*1.11	0.67

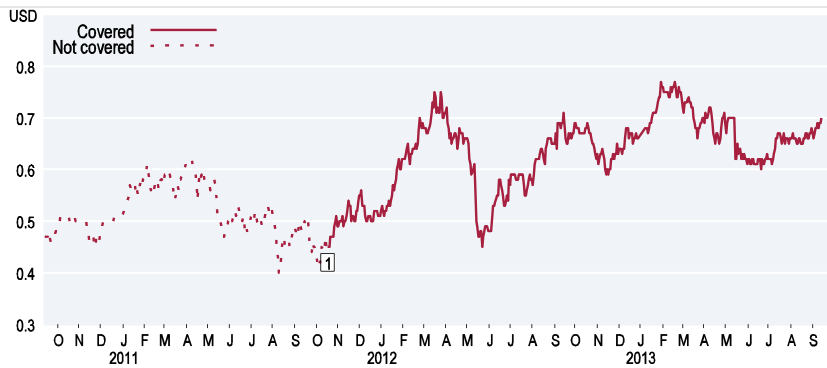
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Surgutneftegaz(pref) (SNGS_p.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 30 2011



	Date	Rating	Target Price	Closing Price
1	18-Oct-11	*ADD MP	-	0.45

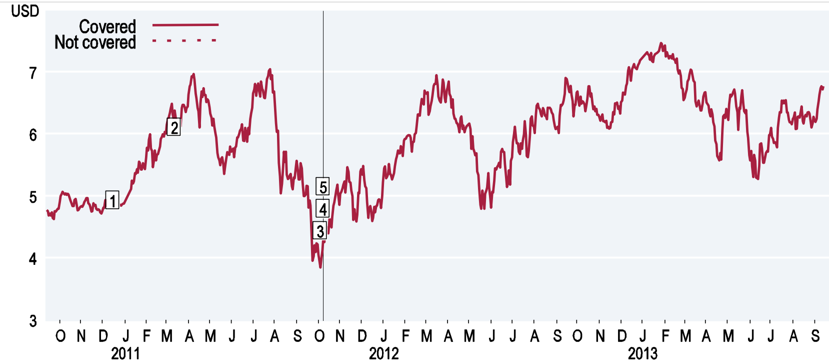
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tatneft (TATN.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 30 2011



	Date	Rating	Target Price	Closing Price
1	15-Dec-10	3H	*5.25	4.83
2	11-Mar-11	3H	*4.69	6.22
3	4-Oct-11	*2M	4.69	3.93
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*2	-	4.11

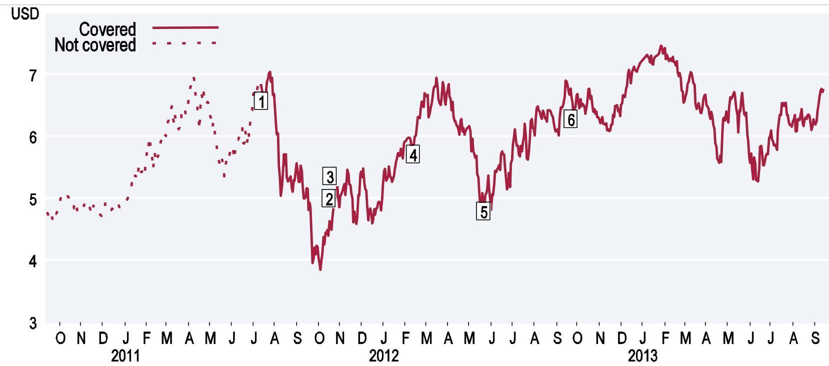
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tatneft (TATN.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 30 2011



	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD LP	-	6.84
2	17-Oct-11	*REM LP	-	4.39
3	18-Oct-11	*ADD LP	-	4.63
4	13-Feb-12	*REM LP	-	5.86
5	22-May-12	*ADD LP	-	4.97
6	21-Sep-12	*REM LP	-	6.77

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tatneft(pref) (TATN_p.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 30 2011

	Date	Rating	Target Price	Closing Price
1	16-Dec-10	*1H	*3.04	2.71
2	11-Mar-11	*3H	*2.72	3.66
3	4-Oct-11	*2M	2.72	2.19
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*2	-	2.33

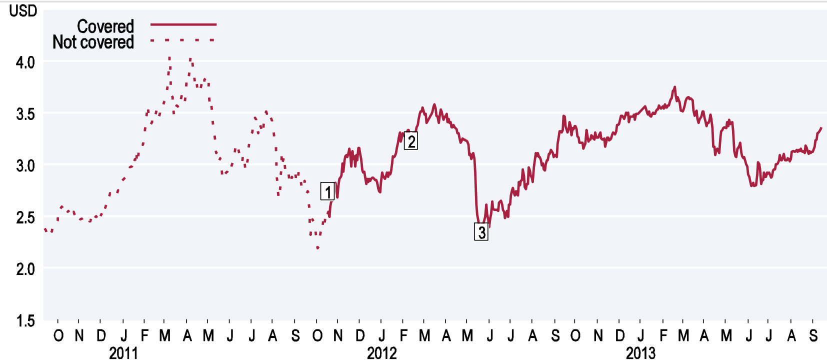
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tatneft(pref) (TATN_p.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 30 2011



	Date	Rating	Target Price	Closing Price
1	18-Oct-11	*ADD LP	-	2.52
2	13-Feb-12	*REM LP	-	3.27
3	22-May-12	*ADD LP	-	2.42

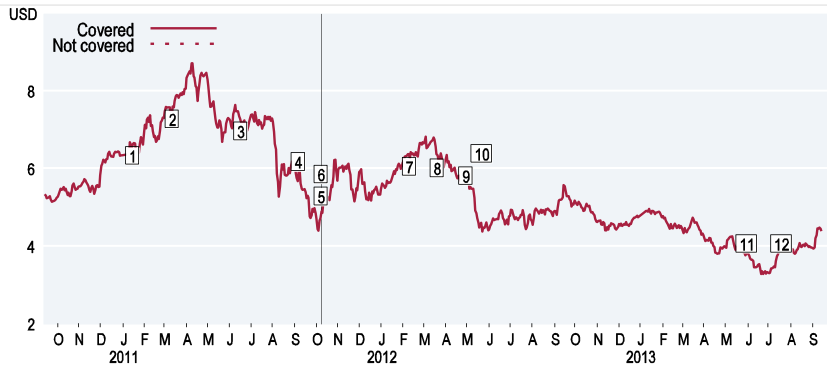
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Gazprom (GAZP.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 16 2011



	Date	Rating	Target Price	Closing Price
1	14-Jan-11	1M	*9.50	6.53
2	11-Mar-11	1M	*10.30	7.29
3	16-Jun-11	1M	*11.00	7.28
4	6-Sep-11	1M	*10.30	5.66
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	10.30	4.70
7	9-Feb-12	1	*8.00	6.36
8	20-Mar-12	*2	*6.50	6.36
9	30-Apr-12	*1	*7.50	5.76
10	22-May-12	1	*7.20	4.59
11	30-May-13	1	*6.80	3.78
12	18-Jul-13	1	*7.00	4.01

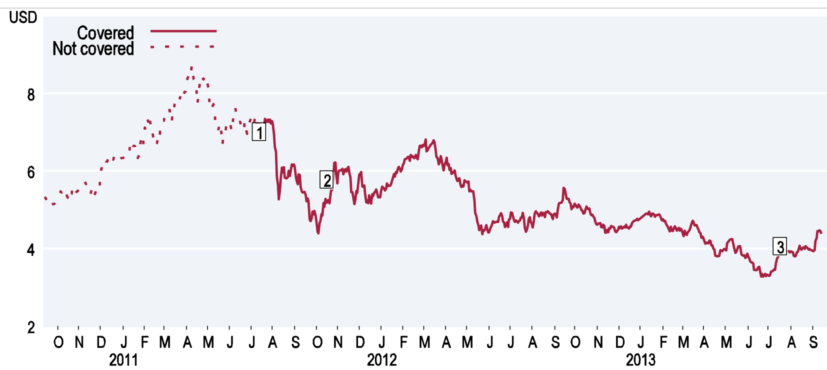
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Gazprom (GAZP.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 16 2011



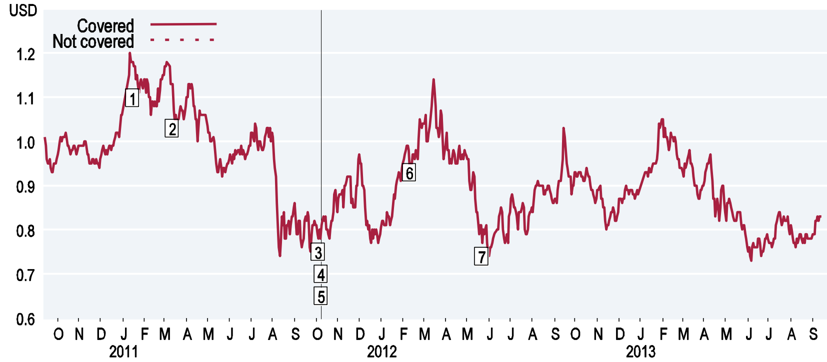
	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD MP	-	7.24
2	17-Oct-11	*REM MP	-	5.18
3	17-Jul-13	*ADD MP	-	4.06

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Surgutneftegaz (SNGS.MM)
Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 30 2011



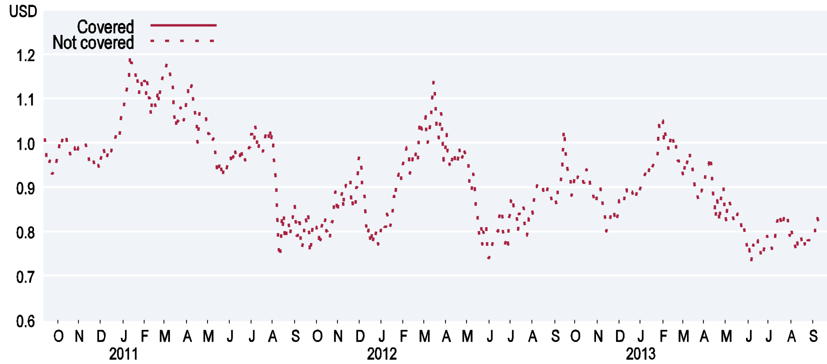
	Date	Rating	Target Price	Closing Price
1	14-Jan-11	2H	*1.15	1.18
2	11-Mar-11	2H	*1.21	1.13
3	4-Oct-11	*1M	1.21	0.79
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*1	1.21	0.78
6	9-Feb-12	1	*1.28	0.98
7	22-May-12	1	*1.17	0.81

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Surgutneftegaz (SNGS.MM)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 30 2011

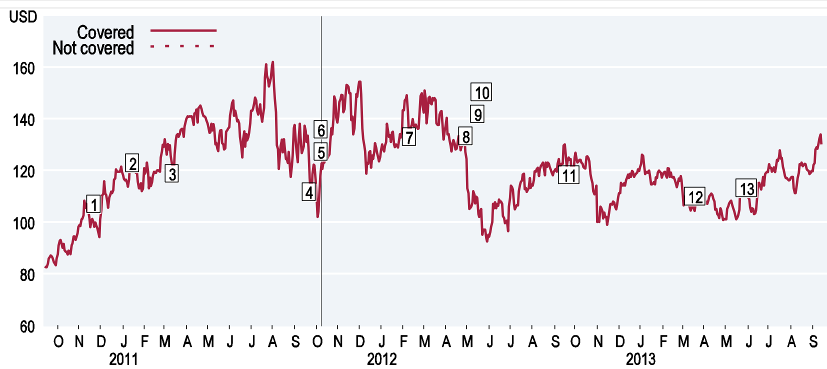


* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Novatek OAO (NVTKq.L)
Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since September 13 2011



	Date	Rating	Target Price	Closing Price
1	22-Nov-10	*2M	*107.00	99.90
2	14-Jan-11	2M	*125.00	120.70
3	11-Mar-11	2M	*130.00	122.70
4	21-Sep-11	*1M	*170.00	129.00
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	170.00	118.00
7	9-Feb-12	*2	*153.00	135.50
8	30-Apr-12	2	*149.00	127.10
9	16-May-12	*1	149.00	109.30
10	22-May-12	1	*139.00	105.00
11	21-Sep-12	1	*153.00	125.00
12	19-Mar-13	1	*151.00	104.30
13	30-May-13	1	*163.00	112.00

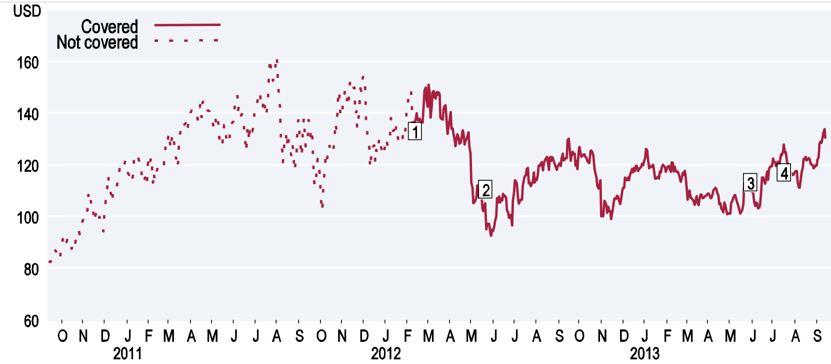
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Novatek OAO (NVTKq.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since September 13 2011



	Date	Rating	Target Price	Closing Price
1	13-Feb-12	*ADD LP	-	136.50
2	22-May-12	*REM LP	-	105.00
3	30-May-13	*ADD MP	-	112.00
4	17-Jul-13	*REM MP	-	127.70

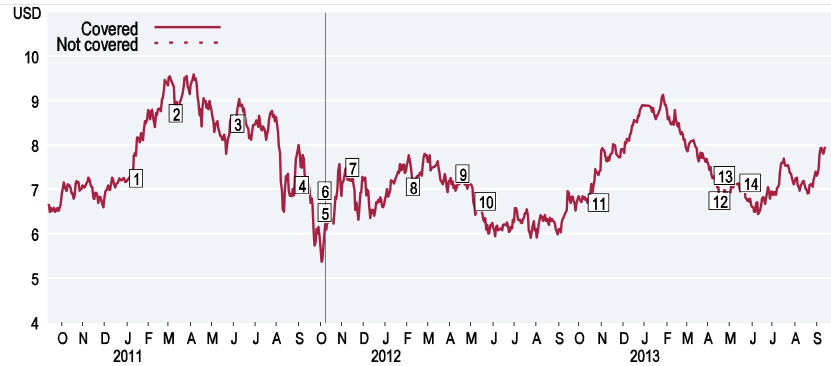
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Rosneft (ROSN.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Ronald Paul Smith
Covered since June 8 2011



	Date	Rating	Target Price	Closing Price
1	14-Jan-11	1L	*9.90	7.75
2	11-Mar-11	*2L	*9.30	8.85
3	7-Jun-11	*1M	*11.30	8.78
4	6-Sep-11	1M	*9.30	7.49
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	9.30	5.99
7	16-Nov-11	1	*9.90	7.30
8	9-Feb-12	*2	*8.20	7.14
9	19-Apr-12	*1	8.20	7.28
10	22-May-12	1	*7.30	6.35
11	29-Oct-12	1	*9.10	7.32
12	17-Apr-13	1	*9.45	6.74
13	24-Apr-13	1	*9.53	6.98
14	30-May-13	1	*9.20	6.79

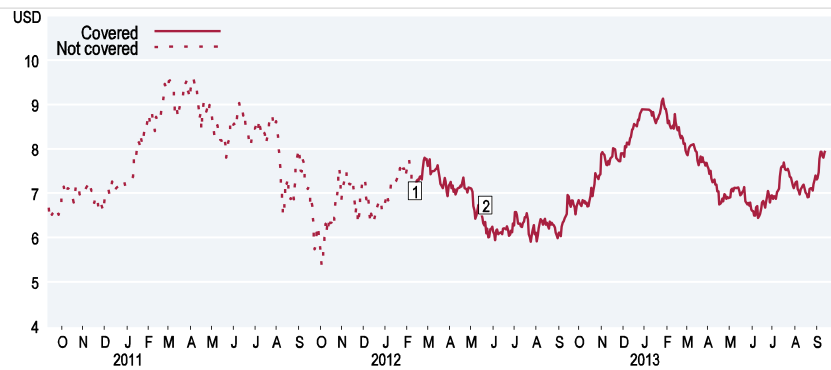
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Rosneft (ROSN.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Ronald Paul Smith
Covered since June 8 2011



	Date	Rating	Target Price	Closing Price
1	13-Feb-12	*ADD LP	-	7.23
2	22-May-12	*REM LP	-	6.35

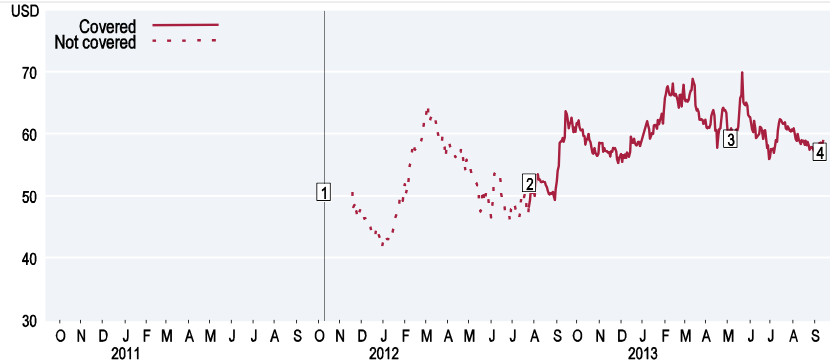
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Bashneft (BANE.MM)

Ratings and Target Price History
Fundamental Research

Analyst: Alexander Bespalov, CFA
Covered since July 25 2012



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		
2	25-Jul-12	*1	*62.50	48.08
3	6-May-13	*2	*60.30	60.55
4	9-Sep-13	*1	*74.20	58.50

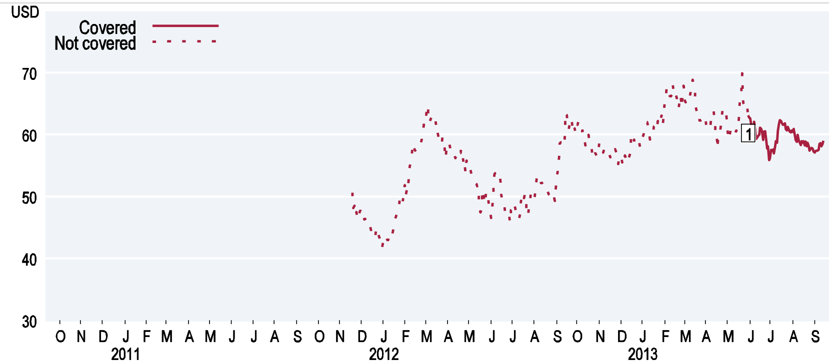
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Bashneft (BANE.MM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Alexander Bespalov, CFA
Covered since July 25 2012



	Date	Rating	Target Price	Closing Price
1	30-May-13	*ADD LP	-	63.06

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2013	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
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