

SIBNEFT

Upgraded from Speculative Buy to Buy

Ticker	Mkt cap (\$ mn)	No of shares (mn)	Net debt, (\$ mn)	EV (\$ mn)
SIBN	7,894	4,741	1,250	9,144

	Revenue \$mn	EBITDA \$mn	Net income \$mn	EPS \$	EPS change	EV/EBITDA x	P/E x	EV/S x
1999	1746.45	547	287	0.060	-214%	16.7	27.5	5.2
2000	2397.92	1,027	665	0.140	132%	8.9	11.9	3.8
2001	3575.68	1,719	1,305	0.275	96%	5.3	6.0	2.6
2002F	3746.92	1,422	896	0.189	-31%	6.4	8.8	2.4
2003F	4445.91	1,634	1,042	0.220	16%	5.6	7.6	2.1

Sibneft reported very strong performance for 2001 under US GAAP, with revenue, EBITDA and net income exceeding our estimates by 20% - 29%. The key factor behind stronger than expected performance was consolidation of several trading subsidiaries last year, which significantly increased domestic revenues. The combination of strong revenue growth and tight cost controls allowed Sibneft to replace Yukos as Russia's most profitable oil major as its EBITDA of \$11.4 per barrel of production was the highest in the sector. Following stronger than expected performance, we raised our 2002-2003 revenue estimates by 16% - 17%, while our EBITDA forecasts were raised by 23% - 28%.

The results also presented an insight into the company's sale of treasury stock, uncertainty about which prompted us to downgrade Sibneft from Buy to Speculative Buy last October. Due to conflicting statements by the company's executives, we feared that Sibneft might not have received adequate compensation for the shares from its core shareholders. Based on presented cash flow data, however, it appears that Sibneft did collect \$568mn in cash for the stock sale, which helped to alleviate our concerns about self-dealing.

Perhaps more importantly, Sibneft also unveiled its medium-term oil production forecast, by which Sibneft should remain an undisputed industry leader in terms of production growth at least through 2005. According to its forecast, Sibneft will produce 42mn tons (304mn bbls) by 2005, a CAGR of 16% from estimated 26.7mn tons (195mn bbls) in 2002. In contrast, we expect production growth rates at Yukos and Surgutneftegaz to decline to single digits after this year.

The combination of superb growth rates, strong domestic market positions, high profitability and management's willingness to share free cash flow with shareholders make Sibneft the best fundamental story in the sector. The only concern investors may have is the high degree of insider ownership, which we feel is more than adequately offset by potential returns. Using our EV/Free cash flow approach, we believe that the stock should be worth \$2.30 - \$2.40 a share, assuming a relatively high discount rate of 20.5%. Our target range implies FY02F EV/EBITDA multiple of 8.5 - 9 times, which we find reasonable given the fundamentals.

We do believe that fundamentally Sibneft is a clear outperformer vis-à-vis peers and the market and strongly recommend its shares for purchase. Following disclosure on treasury stock sale, we also upgrade our recommendation from Speculative Buy to Buy.

Overview of 2001 results

Sibneft reported 2001 US GAAP results that substantially exceeded our most optimistic forecasts. Revenue of \$3.6bn was 20% above our estimate of \$3bn, while EBITDA of \$1.7bn and net income of \$1.3bn were 25% and 29% above our estimates, respectively. Compared to 2000, Sibneft's revenue increased 49%, EBITDA rose 67% and net income almost doubled.

Sibneft's performance on the cost side was very impressive as well. Direct production costs in the upstream business fell from \$1.75/bbl to \$1.70/bbl as higher production volumes per well offset inflationary pressures.

Due to the combination of strong revenue growth and tight cost controls, Sibneft replaced Yukos as Russia's most profitable oil company. Its EBITDA per barrel of production stood at \$11.4/bbl, compared to \$9.4/bbl at Yukos and \$8.1/bbl at Surgutneftegaz (profitability at Lukoil, Tatneft and TNK was even lower).

The bottom line was also positively impacted by \$122mn equity interest in earnings of Onako group of companies and low effective tax rate of 9%.

Although total debt rose from \$593mn in 2000 to \$923mn in 2001, we find the company's balance sheet solid, given Sibneft's strong cash flow generation. Low debt/equity ratio of 23% and strong EBITDA interest coverage of 24 times confirm our view. At present, Sibneft's total debt stands at \$1.3bn (which implies current debt/equity ratio of 0.32) and the company expects it to decline to \$1.1bn by 2002 year-end.

On the cash flow side, operating cash flow of \$1.3bn (up 42% y-o-y) went to finance \$1.3bn worth of capital expenditures and acquisitions. As to financing cash flows, proceeds from new borrowings and treasury stock sale almost entirely offset \$993mn in dividends paid last year, resulting in net financing cash inflow of \$15mn.

Consolidation of traders the key behind strong performance

Clearly, 20% production growth and tight cost controls alone cannot explain such a strong performance, especially if one considers the overall subdued price environment in 2001 as domestic price strength was offset by weaker export prices.

We believe that the single most important factor behind better than expected performance was consolidation of domestic and export trading subsidiaries, where most of the profits accrued prior to 2001. In Sibneft's presentation of 2000 US GAAP results, it was clear that some of the revenues were missing. We raised the issue with the management, which blamed revenue shortfall on high export duties and some other reasons, none of which sounded too credible.

In 2001, however, Sibneft not only switched its exports from long-time trader Runicom SA to in-house Sibneft Oil Trade, but also brought onto its balance sheet three Russian-based trading companies that used to handle Sibneft's domestic sales. Prior to 2001, Sibneft did not report its domestic prices or reported them in a very opaque fashion, making it very difficult to estimate actual cash prices paid by consumers to the company. Moreover, revenue projections made based on actual volumes sold and actual market prices were routinely too high as compared to the actual revenue numbers reported by Sibneft, implying that some of the sales were done at below-market prices. As a result, we were forced to estimate Sibneft's domestic selling prices by applying a certain discount (approximately 20%) to Russian market prices while in reality we were supposed to apply a premium to reflect Sibneft's pricing power in its key domestic markets in Urals and Siberia.

Based on reported 2002 numbers, the adjustment appears no longer needed. Indeed, if we substitute our estimates of Sibneft's domestic prices in 2001 with actual market prices, our 2001 Sibneft's revenue forecast would change to \$3.5bn, just 2% lower than what the company reported.

To summarize, we believe that the reported US GAAP financials confirm that the promised consolidation of trading subsidiaries was in fact completed in 2001 and as a result, Sibneft's financial performance improved dramatically.

Good disclosure on key deals; paid full price for Moscow refinery

In addition to consolidation of its trading subsidiaries, Sibneft's 2001 results reflected continued transparency in respect to the company's M&A activity.

First, it appears that Sibneft collected cash on the sale of its treasury stock to core shareholders in the summer of 2001. While full notes to the accounts will become available only tomorrow, the difference between \$331mn increase in debt (cash in), \$993mn in cash dividends paid (cash out) and net financing cash flow balance of \$15.6mn implies another financing cash credit of \$645mn, the majority of which, we believe, represented \$568mn in proceeds from the treasury stock sale.

Second, the company reflected both the purchase of Moscow downstream assets (\$289mn) and a 25% stake in Slavneft-related investment trust (\$76mn) on its books. We note that Sibneft's valuation of the trust fully coincides with that of TNK, which is another participant in the trust.

We are slightly concerned about Sibneft's investment in Moscow refinery (MNPZ), for which the company paid a full price, but now appears to have difficulties gaining access to its share of refining capacity. According to Sibneft, it paid \$254mn for a 36% stake in MNPZ, which implies \$706mn value for the entire refinery. Based on MNPZ's refining capacity of approximately 92mn bbls, Sibneft paid \$7.7/bbl of refining capacity, compared to \$1 - \$2 per barrel paid in several acquisitions of Russian refineries in recent years.

We note, however, that MNPZ's unique location in Russia's largest gasoline market and high capacity utilization (80% versus less than 50% for other refineries) clearly warrant a premium. In addition, we estimate that once Sibneft regains access to MNPZ, it should earn a 25% - 35% return on investment based on its estimated annual throughput of 29mn bbls and estimated refining margin of \$2 - \$3 per barrel.

Production growth to continue unabated through 2005; needs acquisitions afterwards

Sibneft yesterday officially unveiled its medium-term production plans, by which Sibneft should remain the fastest growing Russian oil company until at least 2005. Sibneft expects to produce 42mn tons (306.6mn bbls) in 2005, a CAGR of 16% for 2003-2005. In comparison, we expect production growth rates at Surgutneftegaz and Yukos, two other fast-growing Russian majors, to fall to single digits after 2002.

We note, however, that as a result of such rapid production growth, Sibneft's reserves/production ratio may fall to 15 times by 2005. This means that Sibneft will have to either aggressively seek new acquisitions to replenish its reserves and maintain growth, or face flat production of 40mn - 45mn tons (292mn - 329mn bbls) from existing reserve base beyond 2005-2006.

In this context, we believe that the acquisition of Slavneft has to become the number one priority for Sibneft. Not only it would allow Sibneft to double its reserves, but would also provide it with 281mn bbls of refining capacity in Russia and Belarus.

2002-2003 forecasts revised higher; recommendation raised to Buy.

There are two main investment implications from the announced results. First, Sibneft's revenues and earnings going forward will be higher than we previously estimated. Second, we believe that due to consolidation of trading companies, the predictability of Sibneft's results has substantially improved as well.

Following the upgrade in our domestic selling price forecasts, we now expect Sibneft to generate EBITDA of \$1.4bn in 2002 on revenues of \$3.7bn, compared to our earlier 2002 revenue/EBITDA forecast of \$3.2bn/\$1.1bn. Our new 2002 net income forecast is \$896mn (\$0.19 a share), 43% higher than previously expected.

We note that our 2002 forecasts for all oil companies are based on \$18/bbl Brent crude oil forecast. After the Russian reporting season ends in June, we are planning to revise this forecast higher in light of actual oil price performance in 1H02. This, in turn, is very likely to result in even higher 2002 forecasts for Sibneft.

For 2003, we have revised our earlier revenue/EBITDA estimates by 16% and 23% respectively.

2002-2003 estimates revised higher

In \$mn	Old		New		Change	
	2002	2003	2002	2003	2002	2003
Revenue	3,208.2	3,827.1	3,746.9	4,445.9	17%	16%
EBITDA	1,110.0	1,327.0	1,421.8	1,633.8	28%	23%
Net income	626.0	776.0	896.2	1,042.4	43%	34%

Source: Aton estimates

Based on our estimated equity discount rate of 20.5% and WACC of 18.6%, we believe that Sibneft should be worth \$2.30 - \$2.40 a share (including investment in Orenburgneft, worth \$0.10 a share). This implies 38% - 44% upside from current levels. And while large insider ownership represents a risk, the upside potential more than compensates for it.

In our October 2001 desknote, we downgraded Sibneft from Buy to Speculative Buy on fears that the company might have received inadequate compensation for the treasury stock sale. The recent disclosure helped to alleviate these fears and since the fundamental story remains intact, we are upgrading our recommendation from Speculative Buy to Buy.

Balance sheet highlights

(\$'000)	2000	2001	Change
Cash and equivalents	27,086	51,649	90.7%
Accounts receivable	448,695	765,794	70.7%
Net oil and gas properties / PP&E	3,191,624	3,241,170	1.6%
Total assets	4,572,569	5,712,796	24.9%
Short-term debt	405,025	314,864	-22.3%
Long-term debt	187,528	608,333	224.4%
Accounts payable and accrued liabilities	382,928	294,562	-23.1%
Estimated income and other taxes	39,298	140,661	257.9%
Minority interest	256,734	1,682	-99.3%
Shareholder capital	3,169,725	4,036,735	27.4%
Total liabilities/share capital	4,572,569	5,712,796	24.9%

Source: Company data

Cash flow highlights

(\$'000)	2000	2001	Change
Net profit / (loss)	674,845	1,305,274	93.4%
Change in net accounts receivable	-122,401	-329,758	169.4%
Change in accounts payable	205,780	-88,366	-142.9%
Change in estimated income taxes	-10,655	101,363	-1051.3%
Net cash from operating activities	920,469	1,311,288	42.5%
Net cash used in investment activities	-748,213	-1,302,378	74.1%
Net cash used in financing activities	-160,901	15,653	-109.7%
Change in cash and equivalents	11,355	24,563	116.3%
Cash and equivalents at end of year	27,086	51,649	90.7%

Source: Company data

Income statement highlights

(\$ '000)	2000	2001	Change
Refined products, oil and gas sales	2,344,453	3,449,145	47.1%
Total revenues	2,397,922	3,575,679	49.1%
Cost and other deductions	1,670,505	2,170,442	29.9%
EBITDA	1,027,417	1,719,153	67.3%
DD&A	300,000	313,916	4.6%
EBIT	727,417	1,405,237	93.2%
Minority interest	61,549	-729	-101.2%
Other income and expenses	-35,103	47,198	-234.5%
Prof it before tax	753,210	1,439,396	91.1%
Net income	674,845	1,305,274	93.4%

Source: Company data

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