

Corporate debt

Russia

# Sibneft<sup>[c]</sup>

## Cost control pays dividends

Oil &amp; gas

Credit rating

**Ba3**

**Sibneft is currently reaping the benefits of tight cost control and is leaving its peers standing in terms of profitability and efficiency. With a YTW of 10.4%, we recommend Sibneft's 11½% US dollar Eurobond as a BUY.**

**Sibneft reported 2001 net revenues up 47% YoY**, a 67% increase in annual EBITDA and a 93% increase in net income. Sibneft's EBITDA margin was some 48% through the period, well ahead of competitors such as LUKoil (28%), Rosneft (38%) and Tatneft (19%).

**Sibneft has set itself challenging production growth targets** that necessitate similar increases in its distribution and marketing capabilities. Sibneft aims to open more than 100 filling stations in key Russian markets by the end of 2002 and should achieve greater production through the enhancement of existing projects and the expansion into new fields.

**The company has led the way in terms of disclosure**, activity in international capital markets, reporting accounts commensurate with US GAAP requirements and production efficiency. Sibneft continues to work with notable international consultancies to boost its activities further and achieve operations of similar quality to those of established international oil companies.

**We believe Sibneft offers investors a significant pick-up over the Russian sovereign and expect this spread to narrow from the current 270bp to around 150bp.** In addition, there is the potential for Sibneft's Eurobond to benefit from the continuing decline in Russian Sovereign yields. We would not be surprised to see the current boom in Russia's domestic corporate market repeated in the Eurobond market, with Sibneft a key beneficiary. We recommend Sibneft as a BUY.

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# Buy

Bloomberg

SIBNEF

11 September 2002

### Bond prices

| Coupon (%) | Maturity | Offer price | YTW (%) |
|------------|----------|-------------|---------|
| US\$11.5   | 07       | 103¾        | 10.4    |

### Financials in brief (US\$m)

|                       | 2001  | 2000  | 1999  |
|-----------------------|-------|-------|-------|
| Revenues              | 3,576 | 2,398 | 1,746 |
| EBITDA                | 1,719 | 1,027 | 547   |
| EBITDA margin (%)     | 48    | 43    | 31    |
| Total debt            | 923   | 593   | 362   |
| Total debt/EBITDA (x) | 0.5   | 0.6   | 0.7   |
| EBITDA/gross int (x)  | 36    | 99    | 26    |
| Op FCF/total debt (x) | 75    | 116   | 69    |
| Debt/equity (x)       | 23    | 19    | 12    |
| Return on assets (%)  | 23    | 15    | 7     |
| Return on equity (%)  | 32    | 21    | 10    |

### Top Russian companies and Sibneft by 2001 crude oil output

| Company                | Rank     | M bbl          | (%)        |
|------------------------|----------|----------------|------------|
| LUKoil                 | 1        | 459.2          | 18.1       |
| Yukos                  | 2        | 424.2          | 16.7       |
| Surgutneftegas         | 3        | 321.1          | 12.6       |
| TNK                    | 4        | 255.7          | 10.1       |
| Tatneft                | 5        | 179.6          | 7.1        |
| <b>Sibneft</b>         | <b>6</b> | <b>150.3</b>   | <b>5.9</b> |
| SIDANKO                | 7        | 114            | 4.5        |
| Rosneft                | 8        | 109            | 4.3        |
| Slavneft               | 9        | 109            | 4.3        |
| Bashneft               | 10       | 86.6           | 3.4        |
| Gazprom <sup>[c]</sup> | 11       | 74.4           | 2.9        |
| Others                 | -        | 259            | 10.2       |
| <b>Total</b>           |          | <b>2,542.1</b> | <b>100</b> |

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# Summary

## ***Sibneft's financial performance has trounced that of its peer group***

Sibneft has proven itself to be the pick of the Russian oil industry. Its financial and operating performance has trounced its peer group and this continues to be recognised by the declining premium that its Eurobond trades over Gazprom, a spread that has narrowed from 120bp to the current 25bp.

Sibneft leads its rivals in terms of production growth, cost efficiency and profitability – the result of a continued focus on costs and modern production practices.

## ***Sibneft has a history in Eurobond issuance***

The company has been reporting accounts in compliance with US GAAP for six years and has a track history of Eurobond issuance dating back to August 1997, through the Russian financial crisis to redemption in August 2000. This was, no doubt, a factor in its successful return to the Eurobond market in January 2002 for US\$250m, and a subsequent US\$150m tap in March 2002. While the company's shareholder structure is not as transparent as we would like, the company is making moves in the right direction and is near the forefront to increase Russian corporate disclosure.

## ***The company's financial standing is undiminished following its 2001 dividend***

Sibneft's decision to pay a dividend of US\$993m for 2001 was certainly a generous one, but one that reflected a number of factors: i) Sibneft's excellent 2001 financial performance, including a near doubling of net income to US\$1,305m from US\$674m a year earlier; ii) Sibneft's superior financial ratios, both relative to its peer group and in absolute terms (debt/EBITDA: Sibneft (0.5x), LUKoil (0.9x), Rosneft (1.0x), Tatneft (1.5x)). EBITDA/gross interest paid: Sibneft (36x), LUKoil (35x), Rosneft (27x), Tatneft (21x)); iii) capital expenditure remains modest against the backdrop of a markedly improved financial performance and; iv) Sibneft's proven reserves as at 1 January 2002 of c4.6bn boe. While some investors may have been surprised at the proximity of such a handsome payout to the company's Eurobond issue, the coincidental timing was more to do with the bond's delay to come to the market. Following the payout, Sibneft's financial standing remains undiminished and the company looks to be in no danger of surrendering its sovereign-ceiling credit rating of Ba3.

## ***Investors should benefit from continued outperformance***

Looking forward, investors should benefit from a continued operational outperformance, the closing of Sibneft's spread over both Gazprom and the Russian Sovereign, and a general decline in Russian sovereign yields. Sibneft's 11½% US dollar Eurobond offers investors a YTW of 10.4% based on the current offer price of 103¾. We recommend it to investors as a BUY.

## History

### ***Sibneft, as we know it, was created in October 1995***

Sibneft was originally created out of four separate companies. On 11 October 1995, the Russian government's controlling stakes in Noyabrskneftegas, the Omsk refinery, Noyabrskneftegasgeophysica and Omsknefteproduct were transferred to Sibneft. The original privatisation plan allowed for 49% of Sibneft's shares to be auctioned off to outside investors, while a controlling 51% would be retained by the government. In December 1995, the government included its Sibneft stake in its shares-for-loans programme, Finance Petroleum Corp (FPC) won this stake in 1997.

From this point, Sibneft implemented a strategy focused at bringing its operations and management into line with international standards. Sibneft also set about raising its ownership of various subsidiaries. Sibneft's main subsidiaries, apart from the acquired companies in 1995, are Kuzbassnefteprodukt, Barnaulnefteprodukt,

Yekaterinburgnefteprodukt, Sevdlovsknefteprodukt, Tyumennefteprodukt, Novosibirsknefteprodukt and SibneftKrasnoyarsknefteprodukt.

***Following the low oil prices of 1998, Sibneft set about aggressively cutting costs***

Following the low oil prices prevailing in 1998, Sibneft set about an aggressive cost-cutting programme. This, together with the effect of rouble devaluation and a recovery in oil prices, saw Sibneft increase its net profits nine-fold by the end of 1999. In 2000, Sibneft launched an ambitious programme to develop new oilfields, including the giant Sugmut field.

***Sibneft was the sixth largest producer in the Russian oil market in 2001***

Sibneft had total proved oil reserves of 4,646m bbl as of 1 January 2002. As at 1H01, Sibneft was the sixth largest producer in the Russian oil market, generating 408,000bpd throughout 2001. In 2002, it has further improved its position, moving to fifth place as of 1H02. Sibneft's total revenues for the year ended 31 December 2001 were US\$3,576m, generating net income of US\$1,305m. Sibneft's export earnings were US\$1,739m (54% of total revenues). Export of crude oil amounted to 35.1% of total crude oil production, while exports of oil products amounted to 20.6% of the total output of oil products.

***Sibneft was the first Russian company to issue a Eurobond***

Sibneft's February foray into the Eurobond market was by no means its debut. Sibneft became the first Russian company to issue a Eurobond when it launched a US\$150m three-year bond in August 1997. The bond carried a coupon of 4% over Libor payable on a quarterly basis. On 18 August 2000, Sibneft redeemed the bond having continued to service all its obligations throughout the Russian financial crisis.

In March 1998, Sibneft issued a US\$200m six-month zero-coupon promissory note, successfully redeemed in September 1998.

November 2001 saw Moody's assign a B1 rating to Sibneft's planned US\$250m issue of three-year Eurobonds and Sibneft thus became the first Russian company to secure a rating that exceeded Russia's (then B2) Sovereign ceiling. Moody's also assigned a Ba2 local currency rating to Sibneft. Just over three weeks later, however, Sibneft announced that it had postponed its planned issue, pending an improvement in market conditions.

***In January 2002, Sibneft successfully floated a US\$250m Eurobond ...***

Conditions did improve and by 31 January 2002, Sibneft successfully managed to float the US\$250m Eurobond. The five-year bond carried a coupon of 11.5% and was placed at par. The bond carried a Ba3 rating from Moody's with a stable outlook. Proceeds from the Eurobond were used to finance capital expenditure and decrease short-term debt.

***... later increased by a US\$150m tap to total US\$400m***

On 4 March 2002, Sibneft re-opened its Eurobond for an additional US\$150m following strong demand during the initial issue. The tap carried a yield to maturity of 10.96% and was launched at a value of 102. The additional amount brought the five-year Eurobond total to US\$400m.

## Operations

***Sibneft is involved in exploration, production, refining and the marketing of natural gas***

Measured by output, Sibneft was the fastest growing oil company in Russia in 2001 and was ranked sixth in terms of oil extraction in the same year. Sibneft is involved in exploration and production of crude oil, and refining and marketing of oil products. Its main upstream assets are in the south Yamalo-Nenetsk region and in the northern part of the Khanti-Mansisk autonomous region, which include the Sugmut field.

***Sibneft's flagship asset is its Omsk refinery***

Sibneft's flagship asset is its Omsk refinery (Sibneft-Omsky NPZ), one of the biggest in Russia. The Omsk refinery had the highest depth of refining in 2001 at 81.4%

(compared with an average 63% throughout in Russia). In October 2001, the refinery acquired the largest sulphuric acid alkylation unit in Russia (enabling it to produce A98 high octane gasoline). Sibneft's refinery throughput by April 2002 had risen by 38% YoY to 342,000bpd.

Shell Global Solutions is conducting a technical audit at Sibneft's Omsk refinery and there are plans for the installation of a new catalytic reforming unit by 2003.

***Sibneft's output in 2001 amounted to 408,000bpd***

Sibneft's output in 2001 amounted to 408,000bpd, up 20% on the previous year; this is expected to increase to 527,000bpd during the current year in keeping with Sibneft's plan to hit its long-term target of 830,000bpd due by 2005. This output growth has been achieved by Sibneft's policy of restructuring and modernising its technology, thus maintaining its competitive edge.

***Sibneft has pursued co-operation with Western companies in a bid to improve its technology***

Sibneft co-operated with Western companies (Schlumberger<sup>rc1</sup>, Pride Forasol, Halliburton, BJ Services and Baker Hughes) in a bid to improve its methods and lower its managing and operational costs. Direct production costs fell to US\$1.70bbl in 2001 from US\$1.75bbl in 2000. In addition, Sibneft is involved in a joint venture with Pride Forasol to drill wells at the Sugmut oil field whose technical characteristics, Sibneft believes, are unmatched in the Russian oil industry.

***Proven reserves as of January 2002 amounted to 4,646m barrels (Miller and Lents)***

Sibneft is concentrating on developing its existing upstream assets, as well as acquiring and exploring new fields, which aim to complement and compensate depleting reserves. Proven oil reserves as of 1 January 2002 amounted to 4,646m bbl (Miller and Lents).

## **Marketing and distribution of oil products**

***Sibneft's marketing and distribution operations need to be expanded to facilitate the targeted rise in production***

Sibneft's needs to expand its marketing and distribution operations to facilitate the targeted rise in production. During the last few years, Sibneft has been actively acquiring various marketing companies in Russia. Its major distributing enterprise is Sibneft-Omsknefteprodukt (which has been part of Sibneft since its inception), which sold 972,000 tons of petroleum products in 2001 (a 9.3% YoY increase) and owns 108 filling stations. Sibneft also owns Kuzbassnefteprodukt (the largest marketing company in the Kemerovo oblast with 68 filling stations) and Barnaulnefteprodukt (a marketing company in Altai Krai with 17 filling stations). Yekaterinburgnefteprodukt and Sverdlovsknefteprodukt (marketing companies in the Urals with a combined 132 filling stations) increased their sales by 150% and 120%, respectively, during 2001.

In August 2001, Tyumennefteprodukt, a retail and wholesale distributor in the promising Tyumen region, became part of Sibneft. Tyumennefteprodukt brought Sibneft a network of 98 petrol stations. In 2002, Sibneft's retail network was also expanded into Krasnayarsk and Tomsk.

***Sibneft's December 2001 purchase of a 36% stake in the Moscow Refinery was its first foray into the western Russia oil market***

Sibneft's December 2001 purchase of 36.79% of voting stock in the Moscow Refinery was Sibneft's first foray into the West Russian oil market. In early August 2002, Sibneft gained a three-year contract to supply 350,000 tons of oil per month to the Moscow refinery, a vast improvement on the 20,000 tons it supplied in the previous month when Sibneft's sales to the refinery had declined considerably. Sibneft's deliveries to the plant had been as high as 250,000-300,000 tons during February-June. The new contract will mean an end to such volatility.

Sibneft's improving activities in the Moscow region prompted plans for the targeting of a 10% share of the region's US\$5bn fuel market. This should be achieved by establishing a network of 100 filling stations over the next few years. Sibneft also has

plans for filling station networks in other key economic regions such as St Petersburg, Nizhniy Novgorod and some Siberian cities. Sibneft's target is to open 100 new outlets this year alone. Sibneft's total investment in its retail business is expected to amount to US\$65m in 2002, with some US\$30m in the Moscow region alone. By the end of 2002, Sibneft plans to control 80 petrol stations, including 30 stations owned.

***Sibneft has been linked with the Russian government's efforts to privatise Slavneft***

Sibneft has recently been linked with the Russian government's efforts to privatise Slavneft. 19.68% of the company, representing the first tranche of the Government's sell-down is expected to be completed this autumn with both TNK and Sibneft expected to make bids (both are existing minority shareholders).

## **Strategy**

In general, Sibneft's management has identified five key strategic goals:

- 1 To focus on long-term profitable growth.
- 2 To enhance and fully realise its resource base.
- 3 To achieve a return on assets comparable with internationally reputable companies in the international oil sector on an asset base of a quality commensurate with the assets of a major multinational oil company.
- 4 To establish a transparent corporate structure with a streamlined management structure.
- 5 To set a new benchmark within the Russian oil industry for efficiency and competitiveness.

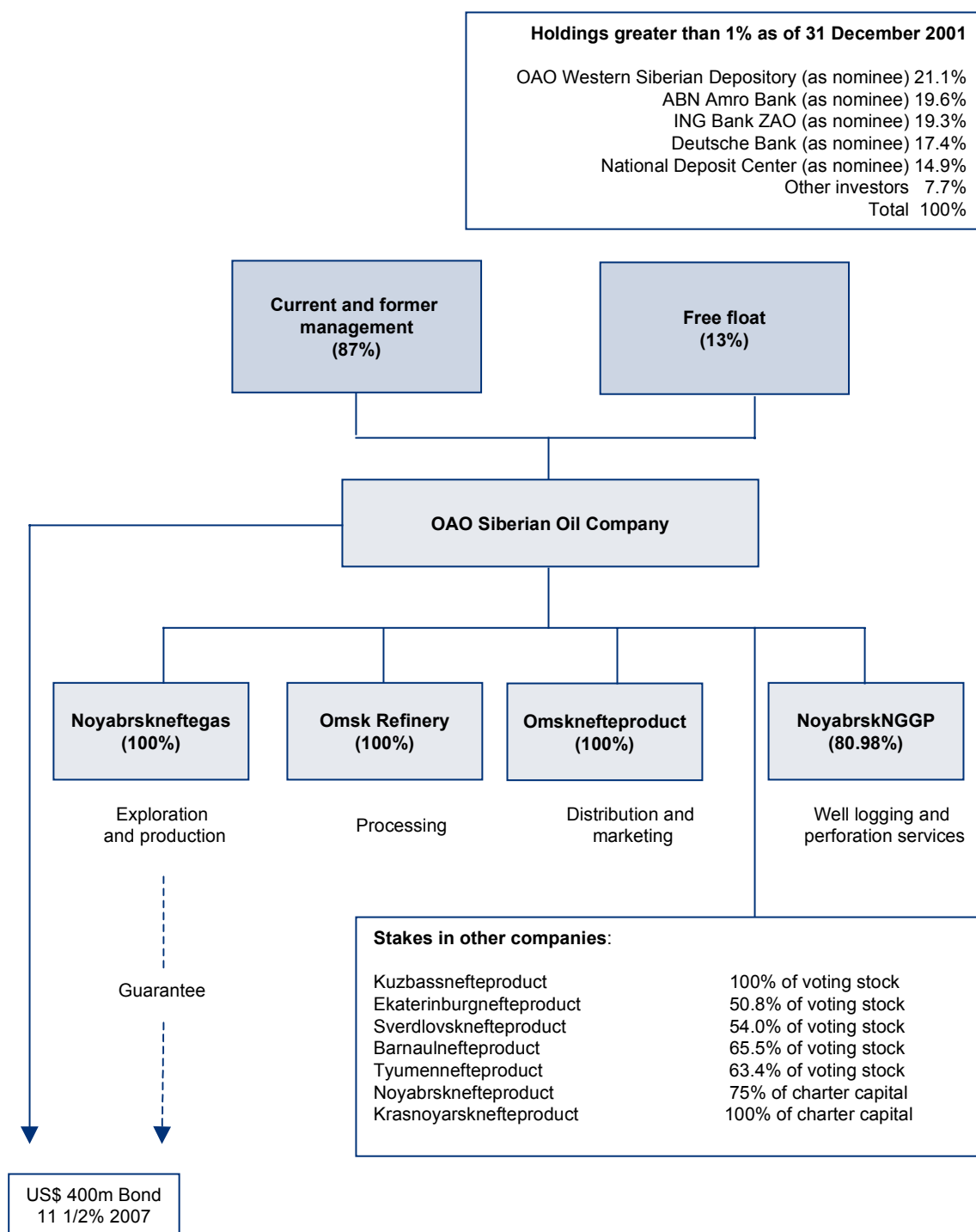
***Sibneft intends to focus on existing assets within Russia while examining opportunities for acquisition and expansion both in Russia and abroad***

Sibneft intends to focus on its existing assets within Russia while examining opportunities for acquisition and expansion both in Russia and abroad.

## **Corporate structure**

Figure 1 shows both the shareholder and inter-company structure. Sibneft's free float is approximately 13%. Together with Roman Abramovich, who was elected governor of Chukotka, current and former management now controls approximately 87% of Sibneft.

**Fig 1 Sibneft – corporation structure**



Source: Company data

## Review of 2001 results

Sibneft was the first Russian oil company to issue its accounts under US GAAP and has six years of accounts filed under this practice.

***Sibneft turned in an EBITDA margin of 48% in 2001***

In 2001, Sibneft was able substantially to strengthen its profit margins turning in an EBITDA margin of 48% (against 42% in 2000), a pre-tax profit margin of 40% (versus 31% in 2000) and net margin of 37% (28% in 2000). EBITDA for 2001 increased to US\$1,719m from US\$1,027m in 2000.

***Core revenue rose 47% to US\$3,449m, which resulted in a 93% leap in net income***

Core revenue rose by 47% to US\$3,449m, which resulted in a 93% leap in net income to US\$1,305m from US\$674m in the previous year. By pursuing its cost-cutting strategy, Sibneft became Russia's most profitable oil company, generating a net income of US\$63.15 per ton of output (on EBITDA of US\$83.17 per ton of output), which surpassed both Yukos at US\$59.76 and TNK at US\$31.74. Sibneft has also been able to achieve a reduction in direct production costs to US\$1.70bbl from US\$1.75bbl a year before. Sibneft's sales figures again indicate its leadership of last year's Russian oil sector with US\$172.98 per ton of output, made possible by an increase in crude oil exports to 35.1% of total output (versus 32.5% in 2000), primarily due to its focus on the development of its marketing network. Export earnings in 2001 amounted to 54% of total revenues, primarily the export of crude oil.

***Sibneft reduced short-term liabilities by US\$90m in 2001***

Sibneft has been aiming to replace its short-term finance, which was arranged at a time borrowings would only be done at high cost, with lower-costing long-term facilities. A considerable reduction in short-term liabilities of US\$90m (from US\$405m at 31 December 2000 to US\$314m at 31 December 2001) is demonstrative of this.

The increase in loans receivable from US\$8.0m at the end of 2000 to US\$299.3m at 31 December 2001 should not be a cause for concern. These loans were mainly to Sibneft's retail subsidiaries at rates dependent on Sibneft's level of control. The increase in the level of lending can be attributed to the extensive expansion in 2001 of the group's retail network (the upgrade of old sites and the development of new sites with third parties) along with other investment.

***Total debt/EBITDA improved to 0.5x from 0.6x through 2001***

Sibneft's debt/equity ratio remained at the relatively low level of 23%. Sibneft also reported a 23% return on assets as well as a 32.3% return on equity, both much improved over the previous year. Total debt/EBITDA improved to 0.5x from 0.6x through the period. In view of Sibneft's exceptional 2001 financial achievement, the company passed a record dividend of US\$993m. Sibneft has a stated dividend policy whereby it will distribute a minimum of 15% of its annual consolidated earnings to shareholders.

A strict comparison between 2001 and 2000 is not entirely fair. In December 2000, Sibneft acquired a 40% interest in Orenburgneft, a consolidated subsidiary of ONAKO, for US\$430m in cash and a 1% interest in ONAKO for US\$46m paid in cash. Orenburgneft earned US\$370m in 2001, of which, by a joint venture agreement whereby Sibneft receives 33% of the company's economics, Sibneft received US\$122m. This is reflected in Sibneft's accounts under other non-operating Income.

In December 2001, Sibneft sold down by 4.6% its stake in Orenburgneft for \$52 million. In August, TNK and Sibneft were believed to be contemplating the terms of a swap agreement whereby Sibneft would exchange its 40% stake in Orenburgneft in exchange for a stake of as much as 10% in TNK.

## Financial analysis

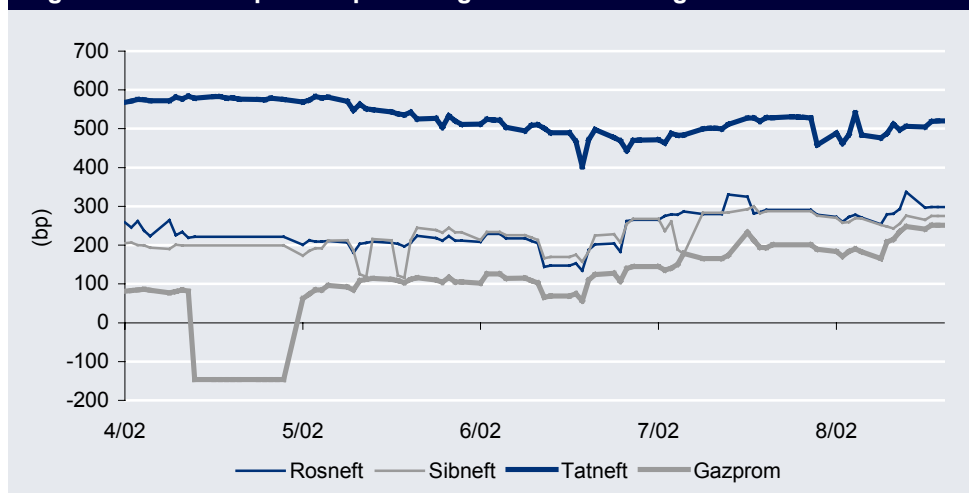
### Debt profile and peer group comparison

We have restricted our peer group analysis to oil companies with outstanding Eurobonds (ie, LUKoil, Rosneft and Tatneft) when looking at financial ratios and to Gazprom, Rosneft and Tatneft when looking at relative Eurobond spreads. LUKoil is not quite comparable for spread analysis given that its bond is a convertible and we have omitted Gazprom from our financial comparison, as it is not strictly an oil company.

*Looking at spreads, Sibneft's Eurobond trades some 25-100bp above Gazprom, 25bp below Rosneft and 240bp below Tatneft*

Looking at spreads, Sibneft's Eurobond trades some 25-100bp above Gazprom, 25bp below Rosneft and 240bp below Tatneft. We believe this is justified by Sibneft's position among Russian oil and gas companies.

**Fig 2 Russian corporate spreads against the sovereign curve**



Source: Bloomberg

*Sibneft's spread over Gazprom has narrowed from 120bp to 25bp*

Gazprom is without a doubt the pre-eminent Russian corporate credit and therefore the Russian corporate Eurobond benchmark. However, the fact that Sibneft's spread has narrowed from some 120bp (the average spread over Gazprom for the April-August 2002 period) to the current 25bp reflects increasing market perception of the narrowing difference in credit quality of the two companies. The keener pricing of Sibneft's Eurobond relative to Rosneft and Tatneft is well justified by both comparable oil statistics and financial results.

**Fig 3 Top Russian companies and Sibneft by 2000 proved oil reserves.**

| Company        | Billion of barrels |
|----------------|--------------------|
| LUKoil         | 14.2               |
| Yukos          | 11.8               |
| TNK            | 7.7                |
| Tatneft        | 6.1                |
| Surgutneftegas | 5.5                |
| <b>Sibneft</b> | <b>4.6</b>         |
| SIDANKO        | 3.2                |
| Bashneft       | 1.3                |
| Rosneft        | 1.0                |
| Slavneft       | 1.0                |

Source: Company data

Tatneft may rank higher than Sibneft in terms of its crude oil reserves (6.1bn barrels against 4.6bn barrels) and production, but its profitability and debt ratios are inferior to

Sibneft's. Rosneft is behind Sibneft in terms of all the key oil statistics and profitability margins. In addition, its debt ratios are also weaker (see Figure 7 for a full table of financial ratios).

**Sibneft ranked sixth in terms of Russian 2001 crude oil output**

**Fig 4 Top oil companies and Sibneft by 2001 crude oil output**

| Company        | Rank     | Millions of barrels | (%)        |
|----------------|----------|---------------------|------------|
| LUKoil         | 1        | 459.2               | 18.1       |
| Yukos          | 2        | 424.2               | 16.7       |
| Surgutneftegas | 3        | 321.1               | 12.6       |
| TNK            | 4        | 255.7               | 10.1       |
| Tatneft        | 5        | 179.6               | 7.1        |
| <b>Sibneft</b> | <b>6</b> | <b>148.9</b>        | <b>5.9</b> |
| SIDANKO        | 7        | 114                 | 4.5        |
| Rosneft        | 8        | 109                 | 4.3        |
| Slavneft       | 9        | 109                 | 4.3        |
| Bashneft       | 10       | 86.6                | 3.4        |
| Gazprom        | 11       | 74.4                | 2.9        |
| Others         | -        | 259                 | 10.2       |

Source: Neftenaya Torgovlya

**Sibneft ranks sixth in terms of refining volumes**

**Fig 5 Top Russian companies and Sibneft by 2001 refining volume**

| Company                 | Rank     | Millions of barrels | (%)        |
|-------------------------|----------|---------------------|------------|
| Yukos                   | 1        | 209.4               | 16.4       |
| LUKoil                  | 2        | 164.5               | 12.9       |
| Bashneft                | 3        | 148.1               | 11.6       |
| TNK                     | 4        | 119.9               | 9.4        |
| Surgutneftegas          | 5        | 115.3               | 9.1        |
| <b>Sibneft</b>          | <b>6</b> | <b>96.8</b>         | <b>7.6</b> |
| Slavneft                | 7        | 83.5                | 6.6        |
| CTK-Moskovskiy Refinery | 8        | 71.7                | 5.6        |
| Rosneft                 | 9        | 53.3                | 4.2        |
| Salavatnefteorgsintez   | 10       | 43.5                | 3.4        |
| Tatneft                 | 11       | 40.9                | 3.2        |
| Gazprom                 | 12       | 36.3                | 2.9        |
| SIDANKO                 | 13       | 27                  | 2.1        |
| Others                  | -        | 63                  | 4.9        |

Source: Neftenaya Torgovlya

**Sibneft's effective cost control has paid off handsomely**

Sibneft's effective cost-control policy has paid off handsomely. In 2001, Sibneft was able to operate with US\$5.59bbl total production costs while LUKoil and Tatneft had much higher total production costs of US\$8.07bbl and US\$7.97bbl, respectively (based on our estimates). Further attention to production costs should decrease this metric still further.

**Fig 6 Production costs (2001) (US\$bbl)**

|                        | LUKoil | Yukos | Sibneft | Tatneft | Petrobras |
|------------------------|--------|-------|---------|---------|-----------|
| Lifting costs          | 3.3    | 1.97  | 1.7     | 3.15    | 3.0       |
| Royalties              | 1.66   | 1.6   | 1.3     | 1.9     | 2.29      |
| Exploration expenses   | 0.12   | 0.1   | 0.04    | 1.0     | 1.1       |
| DD&A                   | 1.08   | 0.4   | 1.65    | 1.0     | 1.85      |
| SG&A                   | 1.91   | 0.7   | 0.9     | 0.65    | 2.01      |
| Other                  | 0.0    | 0.0   | 0.0     | 0.27    | 1.45      |
| Total production costs | 8.07   | 4.77  | 5.59    | 7.97    | 11.71     |

Source: Company data, ING estimates

Although Sibneft increased its borrowings significantly in 2001 and is likely to increase them in 2002, the company's high efficiency facilitates such a rise without a significant deterioration in its financial ratios. We forecast that Sibneft's total debt/EBITDA ratio will

remain the Russian oil industry's lowest and that its free cash flow/total debt will remain the highest in 2002 (compared with LUKoil, Rosneft and Tatneft). In 2001, Sibneft's total debt/EBITDA amounted to 0.5x, while LUKoil, Rosneft and Tatneft had ratios of 0.9x, 1.0x and 1.5x, respectively. We forecast Sibneft's total debt/EBITDA ratio will increase to 0.78x by the end of 2002. We would view an increase in Sibneft's debt/equity ratio from the current 23% to some 35% as acceptable since this should increase Sibneft's capital efficiency. In 2001, Sibneft showed a 23% return on assets and a 32% return on equity, surpassing all three of its Eurobond peers. Sibneft's EBITDA margin hit 48% in 2001 and, while we forecast it to come in at around 43% in 2002, this should still prove a superior performance. Sibneft's competitors had much weaker EBITDA margins in 2001 – 28% at LUKoil, 38% at Rosneft and 19% for Tatneft.

**Fig 7 Financial ratios**

| Metric (US GAAP)                        | Year | Sibneft | LUKoil | Rosneft | Tatneft |
|---|------|---------|--------|---------|---------|
| Revenues (US\$m)                        | 1998 | 1,781   | 6,619  | 1,442   | 2,322   |
|   | 1999 | 1,746   | 7,632  | 1,569   | 2,464   |
|   | 2000 | 2,397   | 13,440 | 2,467   | 5,943   |
|   | 2001 | 3,576   | 13,562 | 2,323   | 4,633   |
| Adjusted EBITDA (US\$m)                 | 1998 | 211     | 77     | -350    | -266    |
|   | 1999 | 547     | 2,290  | 514     | 872     |
|   | 2000 | 1,027   | 4,900  | 1,026   | 1,684   |
|   | 2001 | 1,719   | 3,834  | 872     | 859     |
| EBITDA margin (%)                       | 1998 | 11.9    | 1.2    | N/A     | N/A     |
|   | 1999 | 31.3    | 30.0   | 32.8    | 35.4    |
|   | 2000 | 42.9    | 36.5   | 41.6    | 29.3    |
|   | 2001 | 48.1    | 28.3   | 37.6    | 18.5    |
| Total debt (US\$m)                      | 1998 | 470     | 2,074  | 396     | 1,056   |
|   | 1999 | 362     | 2,497  | 406     | 895     |
|   | 2000 | 593     | 2,312  | 498     | 1,060   |
|   | 2001 | 923     | 3,428  | 910     | 1,263   |
| Total debt/EBITDA (x)                   | 1998 | 2.2     | 26.9   | N/A     | N/A     |
|   | 1999 | 0.7     | 1.1    | 0.8     | 0.9     |
|   | 2000 | 0.6     | 0.5    | 0.5     | 0.6     |
|   | 2001 | 0.5     | 0.9    | 1.0     | 1.5     |
| EBITDA/gross interest paid (x)          | 1998 | 4.5     | 0.5    | N/A     | N/A     |
|   | 1999 | 25.7    | 19.2   | 15.3    | 8.8     |
|   | 2000 | 99.0    | N/A    | 22.0    | 16.1    |
|   | 2001 | 36.4    | 34.5   | 27.3    | 21.2    |
| Free operating cash flow/total debt (x) | 1998 | -21.6   | -6.9   | 23.0    | -18.6   |
|   | 1999 | 68.8    | 27.0   | 22.5    | 33.4    |
|   | 2000 | 116.4   | 47.3   | 18.3    | 18.7    |
|   | 2001 | 75.0    | 4.4    | 4.3     | 2.6     |
| Debt/equity (%)                         | 1998 | 24.4    | 37.1   | 48.1    | 84.2    |
|   | 1999 | 11.9    | 35.3   | 40.9    | 54.8    |
|   | 2000 | 18.7    | 22.0   | 35.4    | 33.1    |
|   | 2001 | 22.9    | 27.7   | 48.7    | 34.2    |
| Return on assets (%)                    | 1998 | 0.7     | 7.6    | -3.1    | -23.8   |
|   | 1999 | 7.4     | 8.5    | 5.7     | 12.0    |
|   | 2000 | 14.8    | 19.4   | 12.2    | 16.5    |
|   | 2001 | 22.8    | 10.6   | 11.1    | 11.0    |
| Return on equity (%)                    | 1998 | 1.9     | 13.1   | -12.0   | -58.4   |
|   | 1999 | 10.3    | 15.0   | 13.4    | 25.6    |
|   | 2000 | 21.3    | 31.5   | 32.4    | 30.2    |
|   | 2001 | 32.3    | 17.0   | 25.6    | 19.6    |

Source: Company data, ING estimates

***Sibneft's foreign exchange risk is mitigated by its high level of export earnings***

Sibneft prefers to borrow in US dollars, which implies it carries a foreign exchange risk and is thus exposed to fluctuations in the US dollar. However, given that crude oil and oil products export earnings accounted for 54% of total revenues this risk is both mitigated and seems manageable. Most of Sibneft's debt (US\$957.5m as of 31 July 2002) is secured or pledged to export receivables.

Sibneft's financing strategy is to replace short-term high-cost finance with longer-term, lower-cost facilities. This should help to lower further the weighted average interest rate from 10.7% in 2000 and 9.5% in 2001 to about 8.0% in 2002. The company's debt redemption profile shows that the peak of payments will be reached between 2004-07 when, on average, US\$311m pa should be paid out.

**Fig 8 Sibneft's debt outstanding as of 31/07/2002**

| Year | Debt to be redeemed (US\$m) | Secured |
|------|-----------------------------|---------|
| 2002 | 43.2                        | Yes     |
| 2003 | 66.7                        | Yes     |
| 2004 | 245.8                       | Yes     |
| 2005 | 201.9                       | Yes     |
| 2006 | 300.0                       | Yes     |
| 2007 | 500.0                       | No      |

Source: Company data

**Capital expenditure**

Despite 20% growth in 2001 production and targeted growth of 29% in 2002, Sibneft's capital expenditure programme is not overly ambitious. In 2001, capex amounted to US\$619m and is forecast to be US\$650m (upstream), US\$50m (refining) and US\$65m (marketing of oil products) in 2002 with US\$800m pa expended in 2003-05. LUKoil had a capex spend of US\$2521m in 2001 yet only produced a 1.6% growth in production. This is another illustration of Sibneft's high operating efficiency.

**Conclusion**

We recommend Sibneft's 11½% US dollar Eurobond as a BUY believing it provides investors with an attractive return (YTW of 10.4%). We believe there is potential for Sibneft's spread over the Russian Sovereign to narrow from the current 270bp to about 150bp. Furthermore, Sibneft's bond would benefit from a continued fall in Russian Sovereign yields.

When general market conditions improve, investors are likely to be looking for a combination of good credit metrics and a premium to the sovereign curve. We have already observed a boom in corporate bonds in the domestic market, and this may well happen to the Russian corporate Eurobond market.

We recommend Sibneft's 11½% US dollar Eurobond as a BUY.

***Sibneft's capital expenditure programme is not overly ambitious***

***We recommend Sibneft as a BUY***

# Financials

**Fig 9 Profit and loss (US\$m)**

|  | 1997           | 1998           | 1999           | 2000           | 2001           |
|--|----------------|----------------|----------------|----------------|----------------|
| <b>Revenues</b>                              |                |                |                |                |                |
| Refined products and oil and gas sales       | 2,616.1        | 1,644.1        | 1,694.5        | 2,344.5        | 3,449.1        |
| Other  | 372.6          | 137.0          | 52.0           | 53.5           | 126.5          |
| <b>Total</b>                                 | <b>2,988.7</b> | <b>1,781.0</b> | <b>1,746.4</b> | <b>2,397.9</b> | <b>3,575.7</b> |
| <b>Expenses</b>                              |                |                |                |                |                |
| Operating expenses                           | 997.7          | 951.0          | 800.9          | 905.9          | 702.3          |
| Selling, general and administrative expenses | 418.6          | 250.9          | 128.6          | 182.2          | 609.0          |
| Cost of other sales                          | 169.7          | 95.6           | 41.7           | 23.9           | 101.8          |
| Depreciation, depletion and amortisation     | 422.1          | 316.6          | 289.8          | 300.0          | 313.9          |
| Exploratory expenses                         | 73.8           | 54.0           | 10.6           | 4.8            | 21.2           |
| Taxes other than income taxes                | 925.5          | 218.1          | 217.6          | 253.7          | 422.2          |
| <b>Total operating costs</b>                 | <b>3,007.4</b> | <b>1,886.3</b> | <b>1,489.1</b> | <b>1,670.5</b> | <b>2,170.4</b> |
| <b>Operating income</b>                      | <b>(18.7)</b>  | <b>(105.2)</b> | <b>257.3</b>   | <b>727.4</b>   | <b>1,405.2</b> |
| <b>Other income (expense)</b>                |                |                |                |                |                |
| Interest received and other income           | 5.2            | 6.8            | 0.5            | 1.0            | 0.7            |
| Interest paid and other expense              | (32.5)         | (53.3)         | (21.8)         | (11.4)         | (47.9)         |
| Other non-operating income                   | 0.0            | 0.0            | 0.0            | 0.0            | 128.8          |
| Other non-operating expense, net             | 19.2           | 1.8            | (30.4)         | (35.1)         | (81.6)         |
| Minority interest                            | 102.2          | (81.5)         | 89.7           | 61.5           | (0.7)          |
| Dividends on preferred stock of subsidiaries | (1.5)          | (1.8)          | 0.0            | 0.0            | 0.0            |
| Currency translation gain                    | 31.7           | 286.8          | 28.3           | 9.7            | 34.9           |
| <b>Total</b>                                 | <b>124.2</b>   | <b>158.7</b>   | <b>66.3</b>    | <b>25.8</b>    | <b>34.2</b>    |
| Income before provision for income taxes     | 105.5          | 53.5           | 323.6          | 753.2          | 1,439.4        |
| Provision for income taxes                   | 81.6           | 17.3           | 8.5            | 78.4           | 134.1          |
| <b>Net income</b>                            | <b>23.9</b>    | <b>36.1</b>    | <b>315.1</b>   | <b>674.8</b>   | <b>1,305.3</b> |

Source: Company data

**Fig 10 Balance sheet (US\$m)**

|  | 1997           | 1998           | 1999           | 2000           | 2001           |
|--|----------------|----------------|----------------|----------------|----------------|
| <b>Current assets</b>                              |                |                |                |                |                |
| Cash and cash equivalents                          | 108.7          | 34.1           | 15.7           | 27.1           | 51.6           |
| Loans receivable                                   | 10.0           | 2.4            | 5.2            | 8.0            | 299.3          |
| Accounts receivable, net                           | 422.8          | 384.6          | 326.4          | 448.7          | 765.8          |
| Inventories, net                                   | 398.6          | 116.5          | 123.7          | 169.1          | 232.9          |
| Pre-paid expenses                                  | 9.6            | 1.9            | 1.6            | 14.8           | 4.6            |
| <b>Total current assets</b>                        | <b>949.6</b>   | <b>539.4</b>   | <b>472.5</b>   | <b>667.7</b>   | <b>1,354.2</b> |
| <b>Non-current assets</b>                          |                |                |                |                |                |
| Long-term investments                              | 118.0          | 21.6           | 18.1           | 533.6          | 930.9          |
| Oil and gas properties, net                        | 3,054.3        | 3,031.5        | 2,732.4        | 2,719.3        | 2,847.8        |
| Property, plant and equipment, net                 | 1,258.4        | 1,181.6        | 877.7          | 472.3          | 393.3          |
| Construction in progress                           | 233.7          | 213.8          | 172.0          | 170.8          | 181.7          |
| Other non-current assets                           | 6.1            | 6.2            | 7.4            | 8.9            | 4.9            |
| <b>Total non-current assets</b>                    | <b>4,670.5</b> | <b>4,454.7</b> | <b>3,807.4</b> | <b>3,904.9</b> | <b>4,358.6</b> |
| <b>Total assets</b>                                | <b>5,620.2</b> | <b>4,994.1</b> | <b>4,280.0</b> | <b>4,572.6</b> | <b>5,712.8</b> |
| <b>Liabilities and shareholders' capital</b>       |                |                |                |                |                |
| <b>Current liabilities</b>                         |                |                |                |                |                |
| Short-term loans                                   | 324.2          | 320.4          | 61.7           | 405.0          | 314.9          |
| Accounts payable and accrued liabilities           | 407.6          | 318.2          | 177.1          | 382.9          | 294.6          |
| Income and other taxes                             | 740.6          | 142.7          | 50.0           | 39.3           | 140.7          |
| Other current liabilities                          | 12.5           | 15.8           | 12.4           | 14.5           | 45.1           |
| Current portion of long-term debt                  | 0.0            | 0.0            | 150.0          | 0.0            | 0.0            |
| <b>Total current liabilities</b>                   | <b>1,484.9</b> | <b>797.1</b>   | <b>451.3</b>   | <b>841.7</b>   | <b>795.2</b>   |
| Dividends payable                                  | 0.0            | 0.0            | 0.0            | 50.7           | 194.6          |
| Site restoration costs                             | 146.5          | 84.1           | 57.8           | 66.2           | 76.3           |
| Long-term debt                                     | 150.0          | 150.0          | 0.0            | 187.5          | 608.3          |
| Long-term taxes payable                            | 14.6           | 21.0           | 16.1           | 0.0            | 0.0            |
| Minority interest                                  | 1,933.8        | 2,015.3        | 704.9          | 256.7          | 1.7            |
| <b>Total liabilities</b>                           | <b>3,729.7</b> | <b>3,067.5</b> | <b>1,230.0</b> | <b>1,402.8</b> | <b>1,676.1</b> |
| <b>Shareholders' capital</b>                       |                |                |                |                |                |
| Common stock                                       | 1.6            | 1.6            | 1.6            | 1.6            | 1.6            |
| Additional paid-in capital                         | 0.0            | 0.0            | 808.3          | 845.5          | 859.0          |
| Treasury stock                                     | 0.0            | 0.0            | 0.0            | -541.7         | 0.0            |
| Reserves   | 1,867.4        | 1,867.4        | 1,867.4        | 1,867.4        | 1,867.4        |
| Retained earnings                                  | 21.4           | 57.5           | 372.6          | 996.9          | 1,308.7        |
| <b>Total shareholders' capital</b>                 | <b>1,890.4</b> | <b>1,926.6</b> | <b>3,050.0</b> | <b>3,169.7</b> | <b>4,036.7</b> |
| <b>Total liabilities and shareholders' capital</b> | <b>5,620.2</b> | <b>4,994.1</b> | <b>4,280.0</b> | <b>4,572.6</b> | <b>5,712.8</b> |

Source: Company data

**Fig 11 Cash flow (US\$m)**

|  | 1997         | 1998          | 1999           | 2000           | 2001           |
|--|--------------|---------------|----------------|----------------|----------------|
| <b>Reconciliation of net inc to net cash prov by op activities</b> |              |               |                |                |                |
| Net income   | 23.9         | 36.1          | 315.1          | 674.8          | 1305.3         |
| Depreciation, depletion and amortisation                           | 422.1        | 316.6         | 289.8          | 300.0          | 313.9          |
| Interest expense on Runicom loan                                   | 0.0          | 0.0           | 0.0            | 0.0            | 20.6           |
| Loss on disposal of property, plant and equipment                  | (1.1)        | (1.5)         | 44.3           | 1.7            | (0.6)          |
| (Gain)/loss on sales of investments                                | 3.6          | 5.1           | 18.2           | 7.0            | (5.8)          |
| Decrease in allowance for doubtful accounts                        | (6.7)        | 0.0           | 0.0            | 0.0            | 0.0            |
| Decrease in provision for obsolescence                             | (35.1)       | (5.6)         | (6.1)          | 0.0            | 0.0            |
| (Decrease)/increase in long term taxes payable                     | 0.6          | 6.5           | 4.9            | (16.1)         | 0.0            |
| Minority interest  | (102.2)      | 81.5          | (89.7)         | (61.5)         | 0.7            |
| Non-cash investing and financing activities                        | 13.2         | (4.9)         | 0.0            | 0.0            | 0.0            |
| <b>Changes in current assets and liabilities:</b>                  |              |               |                |                |                |
| (Increase) in accounts receivable                                  | 72.1         | 117.2         | 79.3           | (122.4)        | (329.8)        |
| Increase in provision for doubtful accounts                        | 0.0          | (10.8)        | (21.2)         | 0.1            | 12.7           |
| (Increase) in inventories  | (21.0)       | 287.7         | (1.1)          | (45.4)         | (63.8)         |
| (Increase)/decrease in prepaid expenses                            | (5.0)        | 7.7           | 0.3            | (13.3)         | 10.2           |
| (Increase) in other non-current assets                             | (1.1)        | (0.1)         | (1.1)          | (1.6)          | 4.1            |
| Increase/(decrease) in accounts payable and accrued liabilities    | (55.1)       | (157.9)       | (167.4)        | 205.8          | (88.4)         |
| Increase/(decrease) in income and other taxes                      | 14.9         | (597.9)       | (92.7)         | (10.7)         | 101.4          |
| Increase in other current liabilities                              | (41.3)       | 3.4           | (3.4)          | 2.0            | 30.6           |
| <b>Net cash provided by operating activities</b>                   | <b>281.7</b> | <b>83.1</b>   | <b>369.4</b>   | <b>920.5</b>   | <b>1,311.3</b> |
| <b>Investing activities</b>  |              |               |                |                |                |
| Investments made   | 0.9          | 30.7          | (8.7)          | (543.7)        | (726.1)        |
| Acquisition of shares in subsidiaries                              | 0.0          | 0.0           | 0.0            | (17.2)         | (10.2)         |
| Proceeds from investments sales                                    | 0.0          | 0.0           | 0.0            | 9.2            | 52.4           |
| Proceeds from disposals of property, plant and equipment           | 15.1         | 0.0           | 0.0            | 34.5           | 0.2            |
| Capital expenditures   | (561.9)      | (184.6)       | (120.4)        | (230.9)        | (618.7)        |
| Net cash used in investing activities                              | (546.0)      | (153.9)       | (129.1)        | (748.2)        | (1,302.4)      |
| <b>Financing activities</b>  |              |               |                |                |                |
| Net increase/(decrease) in short-term loans                        | 204.2        | (3.8)         | (258.6)        | 343.3          | (90.2)         |
| Net increase in long-term debt                                     | 150.0        | 0.0           | 0.0            | 37.5           | 383.6          |
| Dividends paid   | 0.0          | 0.0           | 0.0            | 0.0            | (849.6)        |
| Treasury stock sales/(purchases)                                   | 0.0          | 0.0           | 0.0            | (541.7)        | 571.8          |
| <b>Net cash used in financing activities</b>                       | <b>354.2</b> | <b>(3.8)</b>  | <b>(258.6)</b> | <b>(160.9)</b> | <b>15.7</b>    |
| <b>Increase in cash and equivalents</b>                            | <b>89.9</b>  | <b>(74.6)</b> | <b>(18.4)</b>  | <b>11.4</b>    | <b>24.6</b>    |
| Cash and equivalents at beginning of year                          | 18.8         | 108.7         | 34.1           | 15.7           | 27.1           |
| Cash and equivalents at end of year                                | 108.7        | 34.1          | 15.7           | 27.1           | 51.6           |
| <b>Supplemental disclosures of cash flow information</b>           |              |               |                |                |                |
| Cash paid for interest   | 44.6         | 66.3          | 19.7           | 26.1           | 31.6           |
| Cash paid for income taxes   | 103.4        | 1.4           | 9.8            | 74.0           | 107.7          |

Source: Company data

## ING Financial Markets

|  |   |   |  |  |
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