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Oil and Gas

Sibneft (HOLD, \$3.36) 2003 US GAAP reports meet general expectations, large SG&A jump is worrisome

SIBN

HOLD

Figure 8. Sibneft – statistical abstract, US GAAP

	Revenues	EBITDA	Net Income	EPS	P/S	EV/ EBITDA	P/CF	P/E	EV/ Reserves	EV/ Production	
	\$ mln	\$ mln	\$ mln						\$/boe	\$/boe	
2000	2,398	1,027	675	0.14	5.2	12.1	13.5	18.4	2.54	92.5	
2001	3,576	1,719	1,305	0.28	3.5	7.2	9.5	9.5	2.54	77.1	
2002	4,777	1,803	1,161	0.24	2.6	6.9	9.7	10.7	2.08	48.5	
2003	6,717	2,337	2,278	0.48	1.8	5.3	4.9	5.5	2.08	40.0	
2004E	7,616	2,732	1,905	0.40	1.6	4.5	5.2	6.5	2.08	35.9	
52-week range: \$1.90 (11/19/2003) - \$3.78 (3/31/2004)				Common Shares Outstanding				4,741 mln	Mcap		\$12,421.4 mln

Source: Company reports, Alfa-Bank estimates

Sibneft published its 2003 FY US GAAP results yesterday (July 19). The numbers generally met our expectations, though they were slightly on the lower end, and around the consensus range. Reported revenues grew 40.6% to \$6.717 bln, driven by strong production growth, high oil prices and an increase in crude and resale activity. Revenues appear below our forecast due to a change in presentation - the 2003 sales number was reported net of excise taxes in contrast to previous years. Adjusting for this change, so as to compare oranges with oranges, our 2003 revenue figure nearly pinpoints the reported figure (only 0.8% above). This also means that on a like-for-like basis, the y-o-y increase in revenues was even higher at about 48%, based on the 2002 excise tax guidance provided by the company earlier.

As reported, the company's overall operating costs grew 44% y-o-y to \$4872 mln, which is 1.2% below our expectations. However if one remembers to subtract excise taxes from 2002 TOIT, to make numbers comparable, costs have actually increased 55% and are 5.2% above our adjusted estimate. The item that gave rise to concern was the SG&A, which significantly overshot our adjusted estimate. Assuming that 2002 export duties went into the SG&A line, we need to adjust the figures by subtracting this item from the 2002 SG&A. The result is an 88% actual SG&A growth, which is very steep, even with strong production growth and transport tariff increases taken into account. The company explained that the growth in SG&A (less transport costs) was triggered by an increase in retail operations (especially in Moscow), consolidation of 99% of Sibneft-Yugra and an increase in social expenditures.

The resulting EBITDA undershot our estimate by 8.4% and totaled \$2337 bln (+29.6% y-o-y). Below the operating line, the company posted a \$385 mln gain from the sale of its stakes in ONAKO and Orenburgneft as well as an equity stake in Slavneft profits (in which it holds a near-50% stake). The latter was in fact much higher than we had estimated: the \$468 mln share in Slavneft earnings, as per Sibneft's notes, implies a \$936 mln 2003 net profit for the whole company, which is quite spectacular. This is 22% above our own estimate and three times the number that Slavneft reported in 2001 (the last available IAS reporting period).

Figure 9. Sibneft 2003 US GAAP Financials

	FY02*	FY03	Change, y-o-y	FY03E	Difference from forecast	FY03E (adjusted*)	Difference from forecast
	\$ mln	\$ mln	%	\$ mln	%	\$ mln	%
Revenues	4,535	6,717	48.1%	6,962	-3.5%	6,661	0.8%
Expenses	3,142	4,872	55.1%	4,931	-1.2%	4,630	5.2%
Production costs	1,205	1,786	48.2%	1,821	-1.9%	1,821	-1.9%
SG&A	544	1,025	88.5%	1,149	-10.8%	626	63.8%
DD&A	410	492	20.1%	522	-5.6%	522	-5.6%
Taxes other than income tax	931	1,423	52.9%	1,311	8.6%	1,533	-7.2%
Exploratory expenses	15	54	264.3%	32	66.9%	32	66.9%
Cost of other sales	37	91	148.6%	97	-5.5%	97	-5.5%
Operating profit	1,393	1,845	32.4%	2,031	-9.2%	2,031	-9.2%
Other expense (income)	69	-618	N/M	-723	-14.6%	(723)	-14.6%
Pre-tax profit	1,325	2,462	85.9%	2,754	-10.6%	2,754	-10.6%
Income Tax	163	184	12.7%	397	-53.7%	397	-53.7%
Current tax	163	184	12.7%	397	-53.7%	397	-53.7%
Deferred tax	-	-	N/M	-	N/M	-	N/M
Net income	1,161	2,278	96.2%	2,357	-3.3%	2,357	-3.3%
EBITDA	1,803	2,337	29.6%	2,552	-8.4%	2,552	-8.4%
Operating margin	30.7%	27.5%	-10.6%	29.2%	-5.8%	30.5%	-9.9%
EBITDA margin	39.8%	34.8%	-12.5%	36.7%	-5.1%	38.3%	-9.2%
Net margin	25.6%	33.9%	32.4%	33.8%	0.2%	35.4%	-4.1%
Production	192	230	19.4%	230	0.0%	230	0.0%
Revenue per barrel	23.58	29.26	24.1%	30.33	-3.5%	29.01	0.8%
EBITDA per barrel	9.38	10.18	8.6%	11.12	-8.4%	11.12	-8.4%
Net income per barrel	6.04	9.92	64.3%	10.26	-3.3%	10.26	-3.3%
Effective tax rate	12.3%	7.5%	-39.4%	14.4%	-48.2%	14.4%	-48.2%
Effective tax rate (adjusted for equity stake in affiliates)	13.9%	9.5%	-31.4%	16.8%	-43.2%	16.8%	

Note: * Reported numbers are adjusted to reflect the reclassifications made by the company in 2003

Source: Company data, Alfa Bank estimates

Once again, the company had demonstrated its skill in the rather “dangerous” area of tax optimization. The effective tax rate for 2003 was, according to our calculations, 9.5% (excluding income from equity affiliates from pre-tax profits, so as to avoid counting taxes twice) vs 13.9% in 2002 (on the same basis) and a 24% statutory rate. The implied 2H03 effective tax rate is thus only 16.1% vs. the 24% we have modeled. The company does however expect its effective tax rate to go up to 20% in 2004. The reported bottom line was twice the level of last year’s numbers at \$2278 bln and only 3.3% below our forecast.

The company pleased us with a significant reduction in debt burden: total debt dropped 28.9% to \$1589 mln, while net debt declined 8.1% to \$1485 mln, or 12% below the level we had anticipated. The company’s free cash flow (defined as CFO less CFI) grew more than four fold to \$1471 mln.

The company also held a conference call to follow up the results. The following is a summary of the highlights of the call, including the Q&A session:

- **Operating environment in 2003.** The company’s management claimed that though the Yukos merger, de-merger has absorbed management time, this distraction had little impact on business, and no senior employees have left the firm.
- **Domestic crude sales** did not materially increase, contrary to perception. Greater use of swaps in order to reduce transport costs explains the apparent increase in domestic sales.
- **Lifting costs** increased \$0.07/bbl to \$1.79/bbl, due to higher workover and utility costs. Refining costs \$1.35/bbl, up \$0.20/bbl over 2002.
- **License extended to 2050 – how did it happen?** Russian law does not prevent companies from extending licenses. Sibneft prepared a

“proper” field development plan for specific fields with input from the relevant government agencies. The extension was granted by the Ministry of Natural Resources. Sibneft is now in the process of preparing new plans for all of its fields, in order to systematically extend all licenses.

- **Are there any problems with the horizontal drilling program?** No. The decision to reduce production growth targets was simply due to “over-ambitious” targets that were set early on. Company management admitted that simple planning errors were unrealistically high.
- **Cost pressure** is coming from utility costs and ruble appreciation. The expectation is that lifting costs will rise at levels similar to those in previous years (1.2-4.1% in 2002-2003)
- **Tax audit:** A “routine” audit is currently underway; The Audit Chamber and Tax Ministry have already conducted audits in past.
- **Export infrastructure status.** The company believes that Transneft is doing a “great” job, adding routes, etc. Sibneft expects/hopes that the government will make a decision about large-scale pipeline projects in the mid term (up to 3 years).
- **Sibneft-Yugra/Sibir Energy.** In December 2003, Sibneft increased its stake in Sibneft-Yugra to 99%. The company claims that Yugra dilution occurred in 2002, but was not publicized until now. What is the end game? A 50-50 JV with Sibir Energy? No comment from Sibneft.
- **Has Sibneft studied findings of the Yukos case, and does it believe any arguments apply to Sibneft?** No, Sibneft does not believe that the Yukos case applies to Sibneft. The company’s expectations are based entirely on what Sibneft believes is legally correct and is not taking any cues from the Yukos case.
- **What tax optimization schemes are no longer being used versus 2002?** Sibneft claimed that it stopped using tax optimization schemes in December 2003. The company offered no further comment, but did say that it is not a “charity,” so it is not inclined to pay unnecessary taxes.
- **Once the de-merger is complete,** will the company return to a high dividend policy? No comment – it’s far too early to discuss this matter.
- **How will Slavneft be divided?** Most everything has been agreed upon; but nothing is final yet. The most important thing is that everything is done in line with the spirit and the letter of the law. Company will disclose the final details in a few months. According to the company’s presentation, the legal and technical division process will take up to two years.