

Sibneft: Downgraded To Hold After H1 2002 Figures

	Price (US\$)		Mkt. Cap (US\$ mln)	Recommendation	Target Price (US\$)	Upside/Down side (%)	2002 PE	2002 EV/ EBITDA
	com.	pref.						
Sibneft	1.96	na	9,293	Hold	US\$2.03	4%	9.0	5.8

Sibneft yesterday reported its H1 2002 US GAAP figures, which came out below the market's and our expectations at the EBITDA and net profit levels.

Despite record industry growth in output of 28% year-on-year (y-o-y), the company's revenue fell by 7% on a per bbl of production basis. Moreover, Sibneft's top line included some US\$138 million in revenue generated via the re-sale of crude and products, suggesting that without this item, Sibneft's revenue would have come in well below expectations.

The company's H1 2002 EBITDA came in at US\$786 million, which was 13% below our forecast. This is mainly due to above expected growth in operating costs, which increased 59% y-o-y in absolute terms, or 24% on a per barrel of production basis.

The company's H1 2002 net profit was US\$457 million, which was 21% below our expectations. However, this outturn was affected by asset sales. This resulted in an unexpectedly large net non-operating charge of US\$51 million. Importantly, it appears that the volume growth that is being achieved cannot be sold through the same channels, so that higher production is translating into weakening margins.

The most surprising element in the company's financials was the US\$313 million "advance payment made to a third party to acquire a stake in a major Russian oil and gas company" on behalf of Sibneft. Although pressed, Sibneft's officials did not disclose the name of this company. Nevertheless, we believe that this transaction could be related to the acquisition of an additional share in the investment trust which owns minority stakes in Slavneft and Slavneft's subsidiaries. With capex rising, as planned, the above-mentioned purchase was financed through debt, which at the gross level increased to US\$1,437 billion in H1 2002, from US\$923 million at year-end 2001. Cash balances only rose modestly, from US\$52 million at year-end 2001 to US\$98 million at the interim stage.

This indicates that any fundraising exercise to obtain the (at least) US\$1.3 billion needed to finance the purchase of the government's 75% stake in Slavneft will have to take place in the second half of 2002. Sibneft already obtained a US\$510 million loan facility from a consortium of foreign banks in July 2002, and we understand that it is working hard at closing the funding gap right now. The balance sheet, however, signals that Sibneft has its work cut out to fund the purchase on its own, in particular if the tender proves competitive. This may pave the way for the mooted Sibneft/TNK alliance to bid jointly, or if pressed, for alternative financing from its shareholders to be sought. This is plentifully available, we believe, but would be negative from a transparency perspective.

Due to the higher than expected growth in costs and the reported growth in debt, we have revised down our forecasts for Sibneft. Assuming US\$20/bbl Brent in all future periods (including Q4 2002), this has entailed earnings cuts of 11% this year and 6% in 2003.

We are reducing our recommendation on the stock from Buy to Hold and cutting our twelve-month price target from US\$2.42 to US\$2.03. This primarily reflects this disappointment. However, it also incorporates a variety of other, more subjective, elements. Sibneft's premium rating already incorporates significant hope of success in the Slavneft tender, we believe. It also possibly discounts that Sibneft is seen as a likely take-over candidate by an oil super-major. Without these partly discounted catalysts, though, a trim in the confidence level that we place on the very high mid-term volume growth guidance (from 90% to 85%) and a reduction in the terminal growth rate from 2% to 0%, which is what today's upstream portfolio would allow, have led to the reduction in the target price.

Income Statement

Sibneft's H1 2002 revenue came in at US\$1,984 million, an increase of 19% y-o-y in absolute terms. The growth is mainly attributable to higher production and sales volume of crude, which went up by an industry beating 28% y-o-y. However, on a per barrel of production basis, the company's revenue slipped by 7% y-o-y, reflecting weaker crude oil (Urals averaged US\$21.69 per bbl in H1 2002 versus US\$24.44 in the same period last year) and product prices in the first six months of 2002 as compared to 2001. Reported H1 2002 revenue was 2% above the market consensus and 4% above our own expectations. At the same time, according to Sibneft's presentation, the revenue line included some US\$138 million in re-sales of crude and products purchased by the company's oil trading unit SibOil from third parties. Without this revenue item, the company's top line would have come in below expectations.

On the cost side, the company showed a significant increase in production costs, selling, general and administrative (SG&A) expenses and taxes other than income taxes. Sibneft's H1 2002 operating costs were US\$480 million, meaning a rather eye-catching 59% growth y-o-y. On a per bbl of production basis, which eliminates the effect of higher volumes, Sibneft's production costs shot up by 24% y-o-y.

This is quite a noticeable increase given that Sibneft actually detailed a decrease in unit lifting costs, which went down from US\$1.70 per bbl for the full-year 2001 (the company did not provide the H1 2001 number) to US\$1.52 per bbl in the first six months of 2002. Given that Sibneft managed to lower its lifting costs (we attribute this to higher volumes translating into economies of scale), the reported growth in operating costs can be attributed to higher refining costs at the company's core refinery in Omsk (up by 16%, according to company officials), the addition of crude processing costs in the Moscow refinery (US\$17.5 per tonne on 1.39 million tonnes processed), and the growth in crude and product purchases for re-sale.

Sibneft's H1 2002 SG&A expenses were US\$312 million – up by 77% y-o-y in absolute terms, or 38% on a per bbl of production basis. The growth in SG&A reflects the higher transportation tariffs imposed by Transneft, which hit all Russian oil majors across the board, and Sibneft's inclusion of export duties in this caption. These declined in unit terms on a y-o-y basis.

The growth in taxes other than income taxes (up by 37% y-o-y) reflects the higher tax burden on the oil companies introduced in 2002 when the unified natural resources production tax replaced crude excise, mineral restoration tax and royalty. Sibneft's H1 2002 operating expenses were US\$1,379 million, showing 42% growth in absolute terms and 11% on a per bbl of production basis.

As a result of the higher than expected growth in costs (mainly production costs), Sibneft's H1 2002 EBITDA, which amounted to US\$786 million, came in 13% below our forecast. As compared to H1 2001, Sibneft's EBITDA declined by 10% y-o-y in absolute terms, or by 30% on a per bbl of production basis.

Below the operating profit line, the most noticeable item was a US\$51 million net expense charge recorded under the other non-operating item line. In H1 2001, Sibneft had US\$8 million net income under this line. Company officials explained this item by the loss on disposals of fixed assets and new (worryingly) recurring social expenses.

Sibneft's H1 2002 pre-tax profit was US\$524 million – down by 23% y-o-y. The company continued to enjoy a low effective current income tax rate, of just 13%, an indication that its tax optimisation efforts remain successful given that the statutory income tax rate is 24%. During the presentation, Sibneft's officials suggested that the company will be able to maintain its current effective income tax rate going forward.

Sibneft's H1 2002 net profit was US\$458.5 million, which was 16% below the market consensus and 21% below our forecast. As compared to the first six months of 2001, the company's bottom line shrank by 26%.

Figure 1: Sibneft's H1 2002 Financial Results Vs. Market And Our Expectations, US\$ Million

	Revenue	EBITDA	Net Profit
Market consensus	1,940	849	543
RC estimates	1,916	902	576
Actuals	1,984	786	457
Actuals as % of market consensus	102%	93%	84%
Actuals as % of RC estimates	104%	87%	79%

Source: Sibneft, Renaissance Capital estimates

Figure 2: Sibneft's H1 2002 Income Statement, US\$ Million

	H1 2001	H1 2002	% Change, Y-o-Y
Crude and oil product sales revenue	1,599	1,918	19.9
Other revenue	64	66	3.6
Total revenue	1,663	1,984	19.3
Production costs	(302)	(480)	58.7
SG&A	(176)	(312)	77.4
Cost of other sales	(41)	(41)	0.4
DD&A	(176)	(181)	3.1
Exploratory expenses	(6)	0	-
Taxes other than income taxes	(267)	(365)	36.5
Total expenses	(968)	(1,379)	42.5
EBITDA	871	786	-9.7
EBIT	695	605	-12.9
Interest received and other income	0	5	1,064.5
Interest paid and other expense	(30)	(25)	-18.6
Other non-operating expense	8	(51)	-749.9
Minority interest	(3)	2	-176.0
Currency translation gain (loss)	14	(13)	-195.0
Pre-tax profit	684	524	-23.4
Income tax	(68)	(66)	-2.4
Net profit	616	457	-25.7

Source: Sibneft, Renaissance Capital estimates

Figure 3: Sibneft's H1 2002 Per Barrel Ratios, US\$

	H1 2001	H1 2002	% Change, Y-o-Y
Total revenue per bbl	24.05	22.38	-7.0
Production costs per bbl	-4.37	-5.41	23.7
SG&A per bbl	-2.55	-3.52	38.3
Total operating costs per bbl	-14.00	-15.55	11.1
EBITDA per bbl	12.59	8.86	-29.6
Net profit per bbl	8.91	5.16	-42.1

Source: Sibneft, Renaissance Capital estimates

Figure 4: Sibneft's H1 2002 Margins, %

	H1 2001	H1 2002	% Change, Y-o-Y
EBITDA margin	52.3	39.6	-24.3
Net margin	37.0	23.1	-37.7
Effective income tax rate	9.9	12.6	27.4

Source: Sibneft, Renaissance Capital estimates

Balance Sheet And Debt Analysis

The balance sheet saw a significant increase in gross debt levels, up to US\$1,437 million from US\$923 million at year-end 2001. Noticeably, the growth in net debt translated into only a US\$58 million increase in the cash and cash equivalents position. Loan receivable balances (one to twelve months in tenor and quasi-cash) were at similar levels as at year-end 2001.

Figure 5: Sibneft's H1 2002 Debt Position, US\$ Million

	H1 2001	H1 2002	% Change, Y-o-Y
Short-term debt	608	439	-28%
Long-term debt	315	998	217%
Gross debt	923	1,437	56%
Short-term debt as % of total gross debt, %	34.1	69.4	104%
Cash and cash equivalents	52	98	90%
Loans receivable	299	291	-3%
Net debt	572	1,048	83%
Shareholders' equity	4,037	4,494	11%
Gross debt to book equity, %	23%	32%	40%
Net debt to book equity, %	14.2	23.3	64%

Source: Sibneft, Renaissance Capital estimates

The balance sheet indicates that Sibneft did not have sufficient funds reserved for the sale of a 75% block in Slavneft as of June 2002. Mind you, nobody was expecting that such a large block would be sold back then. At the same time, we still remain reasonably confident that Sibneft has enough financial capacity to pay US\$1.3 billion for the stake in Slavneft. The company obtained a US\$450 million loan facility from a consortium of foreign banks in July 2002, which was recently increased to US\$510 million. This amount, added to the company's free cash flow generating capability in H2 2002, which should be stronger due to a better price environment, gets the company quite far along the way. However, Sibneft could still have its work cut out to raise the funding if the Slavneft sale proves particularly competitive, meaning that it might have to resort to its core shareholders, at least on an interim basis. Overall, we also believe that it is looking increasingly likely that Sibneft and TNK (which is also raising money, but an insufficient amount to stage a sole bid) will team up, or at the very least not compete against one another, for Slavneft.

Figure 6: Sibneft's H1 2002 Balance Sheet, US\$ Million

	H1 2001	H1 2002	% Change, Y-o-Y
Cash and equivalents	40	98	146.1
Loans receivable	72	291	303.0
Accounts receivable	984	943	-4.2
Inventories	238	283	18.7
Other short-term assets	32	18	-43.8
Current assets	1,367	1,633	19.5
Long-term investments	629	1,227	95.0
Oil & Gas properties	2,628	3,027	15.2
Property, plant and equipment	372	491	32.1
Other long-term assets	173	149	-14.4
Total long-term assets	3,802	4,893	28.7
Total assets	5,169	6,526	26.3
Short-term loans	533	439	-17.6
Accounts payable	309	327	5.8
Other short-term liabilities	174	183	5.4
Current liabilities	1,016	949	-6.6
Long-term debt	271	998	268.3
Other long-term liabilities	691	85	-87.7
Total long-term liabilities	962	1,083	12.5
Minority interest	23	0	-100.0
Total shareholders' equity	3,167	4,494	41.9
Total liabilities and shareholders' equity	5,169	6,526	26.3

Source: Sibneft, Renaissance Capital estimates

Cash Flow Statement

Sibneft's H1 2002 operating cash flow was US\$453 million, which was 84% up y-o-y. The growth is mainly attributable to a lower increase in working capital requirements in H1 2002 as compared to the same period last year. The company's capital expenditures in H2 2002 doubled y-o-y, to US\$430 million, which is in line with Sibneft's guidance of US\$800 million capex for the full year 2002. The company also devoted US\$311 million towards investments (see below), which, alongside other items, led to a cash outflow on investing activities of US\$729 million – up 100% y-o-y. Sibneft's H1 2002 free cash flow was negative, to the tune of US\$276 million, which was financed through an increase in borrowings.

Investments

In the notes to its unaudited consolidated financial statements, the company reported that it made a US\$313 million advance payment to an undisclosed third party to acquire a significant stake in an unnamed Russian oil and gas company on behalf of Sibneft.

During the presentation, Sibneft's officials refused to disclose the name of the company. Despite the secrecy, we believe this acquisition involves the purchase of additional stakes in the investment trust which owns minority stakes in Slavneft and its subsidiaries. In our recent report on Slavneft/Megionneftegas (*'Slavneft & Megionneftegas: Privatisation Implications'*, published on October 22, 2002), we estimated that the trust had a 29% stake in Slavneft through direct equity interest in the holding company and direct stakes in the subsidiaries. Estimating that the value of this stake is US\$550 million suggests that the value of an additional 50% stake in the trust might have cost US\$270 million, a number that is fairly consistent with the identified outlay.

Additionally, the company discussed a 2001 advance payment of US\$68 million to a 50%-owned investee, which used the contributed cash to fund one half of the purchase of a 30% share interest in a Russian utility company. Sibneft's officials did not disclose the name of the company, however, the price paid for the stake suggests that the utility has an equity value of US\$453 million.

Figure 7: Sibneft's H1 2002 Cash Flow Statement, US\$ Million

	H1 2001	H1 2002	% Change, Y-o-Y
Net income	616	457	-25.7
DD&A	176	181	3.1
Other non-cash items	9	25	164.5
Cash flow	801	663	-17.2
Changes in working capital	(554)	(210)	-62.1
Operating cash flow	246	453	83.8
Purchase of investments	(149)	(311)	109.6
Acquisition of shares in subsidiaries	(11)	(20)	76.7
Proceeds from investment sales	0	17	-
Proceeds from fixed assets disposal	2	16	935.5
Capital expenditure	(206)	(430)	109.4
Investing cash flow	(364)	(729)	100.4
Net borrowings	200	514	157.0
Dividend paid	(50)	(191)	283.0
Financing cash flow	150	322	115.0
Net cash flow	33	47	42.0
Cash at the beginning of the period	27	52	90.7
Cash at the end of the period	60	98	64.0

Source: Sibneft, Renaissance Capital estimates

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