

Sibneft: Asset Swap With TNK

	Price (US\$)		Mkt. Cap (US\$ mln)	Recommendation	Target Price (US\$)	Upside/Down side (%)	2002 PE	2002 EV/ EBITDA
	com.	pref.						
Sibneft	2.06	na	9,767	Buy	US\$2.42	17%	8.4	5.7

Sibneft and the Tyumen Oil Company (TNK) yesterday issued a joint press release announcing that the parties had reached an agreement to swap assets. The agreement will allow Sibneft to exchange its equity stakes in Orenburgneft (38%) and Onaco (3%) for an 8.6% stake in TNK International. The latter is an offshore registered holding company, which owns a 97% stake in OAO TNK, a 91% stake in Onaco, a 78% stake in the Ukrainian refinery Lisichansknefteorgsitez, and a 29% stake in RUSIA Petroleum, the licence holder for the giant Kovytkha gas deposit in Irkutsk.

In addition to the equity stake, Sibneft will have representation on TNK International's board of directors, a guaranteed level of dividend payments, and a put option to sell its stake in TNK International back to its current shareholders. The parties did not disclose the terms of the option. According to Sibneft officials, TNK International has guaranteed that Sibneft will receive dividends that are equivalent to around one-third of Onaco's consolidated net profit.

We believe that the deal between Sibneft and TNK will serve the interests of both parties. TNK International will move ahead with the consolidation of its subsidiaries and simplification of its asset structure, which in our view would be key to ensure a successful IPO or a sale to a strategic investor. Sibneft, of course, is able to exchange its minority stakes in TNK International subsidiaries for an equity stake in the parent company, which may potentially become a publicly held company in 2004-2005. Additionally, from a Sibneft perspective, there would seem to be other benefits:

- **Clear exit opportunity:** Although TNK International's main shareholders have recently announced that the IPO, initially planned for 2003, would be delayed, we believe that the company is still interested in selling a part of itself on the market or to a strategic investor after 2003. Even if TNK International's IPO plan does not materialise in the future, Sibneft has secured an exit opportunity through the put option arrangement. While the parties did not disclose the terms of this put, we would expect that the option's strike price is equivalent or above TNK International's implied valuation from the current deal, given that in 2001, when Sibneft initially discussed the swap of its Orenburgneft stake into equity in Onaco with TNK International's shareholders, it was asking for a put option with a strike price considerably above the valuation of Orenburgneft at the time.
- **A guaranteed dividend stream:** We view the dividend payment agreement as a guaranteed cash flow stream to Sibneft and the successor to a prior arrangement. Last year, Sibneft received US\$122 million from Onaco through a partnership arrangement, a sum equivalent to around one-third of Onaco's group-wide net profit.
- **A cash raising opportunity:** In our view, Sibneft may use its stake in TNK International as collateral for an additional loan to finance the purchase of a 75% stake in Slavneft, scheduled to be sold by the government in the next several months. TNK International has had due diligence carried out on it for a proposed eurobond and is a well know credit in its own right.

Having said all the above, the valuation attached to TNK International in the deal looks quite generous. Based on Orenburgneft and Onaco's prices as at the close of the market yesterday, the parties valued a 100% equity stake in a fully-consolidated TNK International at some US\$3.3 billion, which suggests an enterprise value of US\$5.9 billion, or US\$23.5/boe in terms of EV/Production. This valuation bears only a slight discount on LUKOIL's 2001 EV/Production (US\$25.8/boe). We consider that TNK International deserves a deeper discount to LUKOIL, given a smaller asset base, lower growth opportunities, a higher debt burden, and no liquidity of the equity stake.

In theory, one of the reasons behind our very high valuation of TNK International is that we are using a different asset base for TNK International. The parties may have agreed that the shareholders of TNK International will transfer their 69% stake in Sidanco, which is owned by a separate entity (TNK Industrial Holding), into TNK International. Although we have no specific evidence that this is the case, this would lower the implied EV/Production for TNK International to US\$17.9/boe. Additionally, the size of TNK International's net debt could well be lower in the parties' calculations than

our own, given that the benign price environment since Q2 should have enable substantial free cash flow generation and debt repayment.

Figure 1: Implied Valuation Of TNK International In The Sibneft/TNK Deal

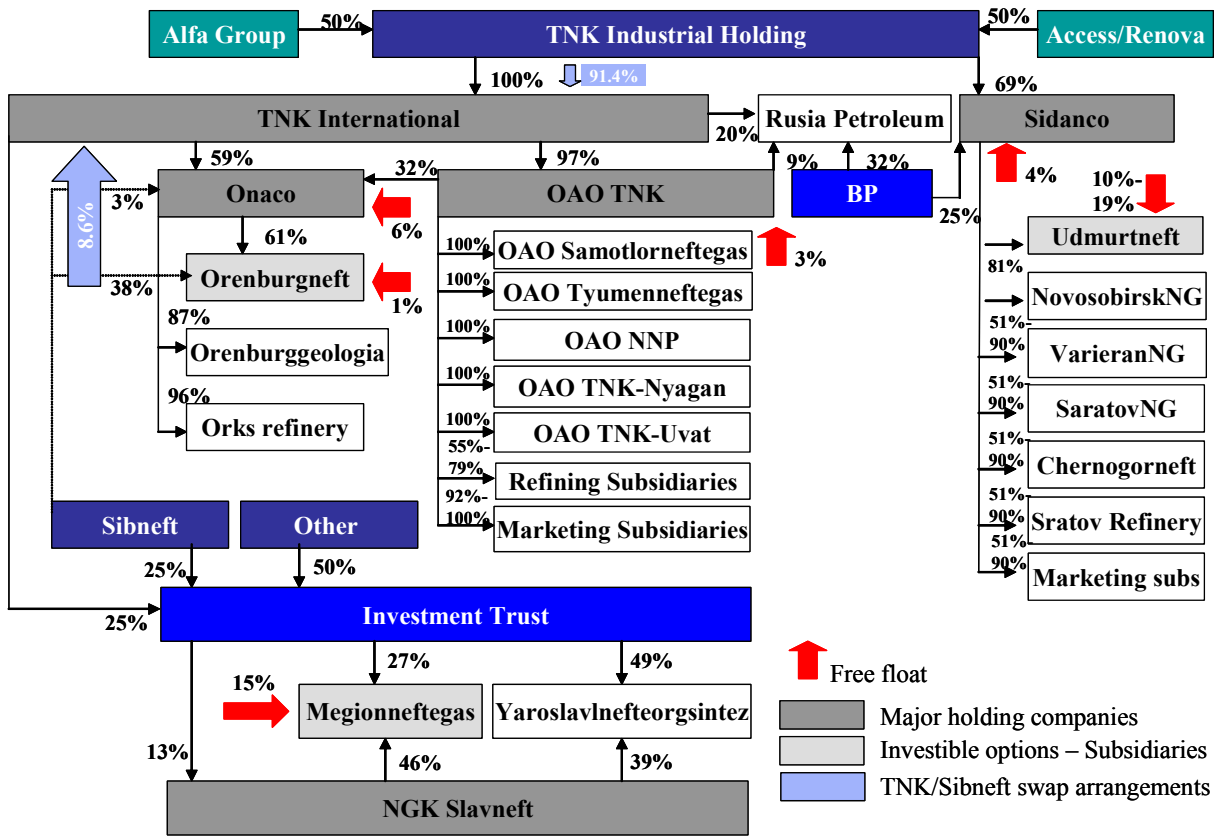
Market Capitalisation Of Orenburgneft, US\$ Million	697.1
Sibneft Stake In Orenburgneft	38.00%
Value Of Sibneft's Stake In Orenburgneft, US\$ Million	264.90
Market Capitalisation Of Onaco, US\$ Million	672.2
Sibneft's Stake In Onaco, %	3.00%
Value Of Sibneft's Stake In Onaco, US\$ Million	20.166
Total Value Of Sibneft's Stakes In Onaco and Subsidiaries, US\$ Million	285.06
Sibneft's Stake In TNK International, %	8.60%
Implied MC Of TNK International, US\$ Million	3,314.70
Net Debt Of TNK International, US\$ Million	2,540.50
Implied EV Of TNK International, US\$ Million	5,855.20
TNK International Gross Production 2001, Million boe	249
Implied EV/Production, (US\$/boe)	23.51
TNK International Gross Production Including 69% Stake In Production Of Sidanco, Million boe	327.7
Implied EV/Production, (US\$/boe)	17.87

Source: Company data, Renaissance Capital estimates

The deal between Sibneft and TNK marks a stronger partnership between the companies. It also suggests that the parties may submit a joint bid for the 75% stake in Slavneft, or, at the very least, that they are unlikely to compete. As the companies already own a 50% interest in an investment trust that holds minority stakes in Slavneft and its subsidiaries, we believe that a TNK-Sibneft alliance would be strong competition for other would-be participants in the auction.

The deal also raises a very interesting question about whether TNK International shareholders will offer similar terms to minority shareholders in Onaco and Orenburgneft, i.e. a buy-back or swap terms that include swapping shares into TNK International stock. According to the Reuters news agency, the President of Alfa-Group (a major shareholder in TNK International) said that, by the end of the year, the company would offer Onaco's minority shareholders the option of swapping their shares for shares in TNK (we estimate the free float of Onaco is 6%). Given that TNK International has recently established an advisory board on corporate developments and corporate governance, we would expect that TNK shareholders would offer favourable conversion and buy-back terms to Onaco and Orenburgneft's minority shareholders. However, this event, in our view, is likely to follow market purchases of Onaco and Orenburgneft shares.

Figure 2: TNK International's Major Holdings



Source: Company data, Renaissance Capital estimates

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