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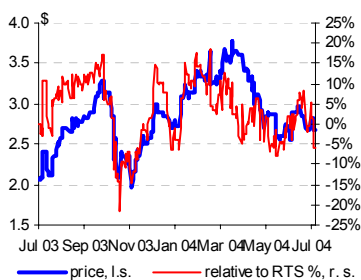
## 2003 RESULTS IN LINE; STRONG 2004-05 AHEAD

Sibneft yesterday released 2003 US GAAP consolidated results that met our estimates at the EBITDA level and exceeded our net income estimates by 4.4% due to a lower effective income tax rate than expected. Net income was also aided by the contribution from Sibneft's equity investments, mainly its 50% interest in Slavneft, which returned \$468mn in equity income and \$219mn in dividends to Sibneft. Operating cash flow was also very strong at \$2.5bn.

**Model update leads to lower EBITDA estimates, but higher target price.** Based on the reported results and management guidance during the conference call, we have adjusted our model. Although the changes in our revenue and production assumptions prompted us to trim our revenue and EBITDA estimates for 2004-05, net income was little affected due to an increase in the expected contribution from Slavneft. We also revised upwards our estimate of Slavneft's value from \$2.7bn to \$4bn, which led to an increase in Sibneft's target price to \$3.4 a share.

**The results have shown again that Sibneft remains the best-managed Russian oil company,** with a very good cost performance in a challenging environment and a proactive response to changing industry dynamics. We were also pleased to see that Sibneft remained the profit center for its core and portfolio shareholders alike as all profits from Slavneft and other investments have flowed through Sibneft's own P&L. Also, we expect Sibneft to resume its policy of cash distributions and/or accelerate the search for a strategic partner once the de-merger with Yukos is finalized.

**Not a Buy due to risks, but a very sound speculative alternative to Yukos.** The continued political uncertainties surrounding the company's principal shareholders and its de-merger with Yukos prevent us from upgrading the stock to a fundamental Buy. It is also worth remembering that Sibneft's portfolio investors were excluded from the original deal with Yukos, a sign of how management is likely to treat minorities if another merger deal materializes. However, in the portfolio management context, Sibneft also represents a very healthy alternative to Yukos – it offers similar upside in the event of a positive resolution to the conflict at a fraction of the potential downside.



Ticker	Rating	Current price, \$	Fair value, \$ (end-04)	Upside / Downside
SIBN	Hold	2.62	3.43	31%
Capitalization & stock data		Com.	Financials (US GAAP), \$mn	
Market cap, \$mn		12,422	2003	2004F
Net debt (cash), \$mn (end 03)		1,485	2,392	2,541
EV, \$mn		13,907	2,620	2,457
Shares out., mn		4,741	1,956	1,908
Free float, (est.)		8%	2005F	2006F
Local shares per ADR		10.00	1,633	1,847
2003 dividend, \$		0.42	1,908	1,847
Dividend yield (%)		16%	5.8	5.3
			5.5	5.6
			6.5	6.2
			7.6	6.5
			6.5	6.7

\* Net income is adjusted to exclude FX gains/losses, inflationary gains/losses and other non-recurring items

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## Reports in line 2003 US GAAP results

Sibneft yesterday released 2003 US GAAP consolidated results that met our estimates at the EBITDA level and exceeded our net income estimates by 4.4% due to a lower effective income tax rate than expected.

**Total revenue of \$6.72bn was 4.2% lower than forecast because Sibneft decided to exclude excise tax from its top line starting with the 2003 results.** Adding back the excise tax, which we estimate at \$358mn, total revenue would have been \$7.07bn, or in line with our estimate of \$7.01bn. The reported figure was still slightly below the consensus of \$6.85bn.

### 2003 revenue at a glance

In \$mn	2002	2003	chg y-o-y
Crude oil export sales	1,840	2,386	30%
Crude oil domestic sales	207	585	183%
Oil product export sales	722	1,259	74%
Oil product domestic sales	1,566	1655*	6%
Other	442	831	88%
Total revenues	4,777	6,717	41%

\*excludes excise tax from 2003

Source: Company data; Aton estimates

**Operating costs matched our expectations, although there were some changes in reporting non-income taxes.** In line with sector-wide trends, costs increased sharply due to surging transportation expenses and non-operating taxes, as well as the strengthening ruble. Transportation costs were up 57% to \$628mn, while non-income taxes soared 59% to \$1.42bn (excluding excise taxes). Total cash costs surged by 46% y-o-y to \$4.33bn, in line with the expected \$4.32bn (excluding excise taxes).

**Lifting costs increased marginally to \$1.79/bbl from \$1.72/bbl in 2002, demonstrating good cost control by management.** We note that in 1H03 lifting costs were only \$1.68/bbl, implying 2H03 lifting costs of \$1.90/bbl. Direct refining costs for the Omsk refinery increased from \$1.15/bbl in 2002 to \$1.35/bbl in 2003. However, Sibneft confirmed at the conference call that like other Russian oil companies it continues to feel pressure from general cost inflation, especially due to rising utility costs and ruble strength and expects lifting costs to grow by approximately \$0.05/bbl during 2004 and probably in 2005.

### Summary of Sibneft 2003 US GAAP consolidated results

In \$mn	2002	2003	Change y-o-y	1H03	2H03	Change
<b>Total revenues</b>	<b>4,777</b>	<b>6,717</b>	41%	<b>3,438</b>	<b>3,278</b>	<b>-5%</b>
Total operating expenses (excluding depreciation)	-2959	-4379	48%	-2,342	-2037	-13%
<b>EBITDA</b>	<b>1,818</b>	<b>2,337</b>	29%	<b>1,096</b>	<b>1,241</b>	<b>13%</b>
DD&A	-410	-492	20%	-239	-253	6%
Operating income	<b>1,393</b>	<b>1,790</b>	<b>28%</b>	<b>856</b>	<b>934</b>	9%
Pretax income	1,325	2,462	86%	1,449	1,013	-30%
Net income (reported)	1,159	2,278	97%	1,378	900	-35%
<b>Net income (ex. one-off gains)</b>	<b>1,158</b>	<b>1,893</b>	<b>63%</b>	<b>1,304</b>	<b>589</b>	<b>-55%</b>
<b>Operating cash flow</b>	<b>1,286</b>	<b>2,523</b>	<b>96%</b>	<b>908</b>	<b>1,615</b>	<b>78%</b>
EBITDA margin	38%	35%	-3%	32%	38%	-3%
Operating margin	29%	27%	-3%	25%	28%	-2%
Net margin	24%	28%	4%	38%	18%	10%

Source: Company data; Aton estimates

**The reported EBITDA of \$2.34bn exactly matched our forecast of \$2.34bn.** This was however 15.5% lower than the consensus estimate of \$2.77bn (according to Bloomberg) and may prove disappointing to some. The EBITDA margin declined 3 percentage points to 32% as expected.

**Net income of \$2.28bn was 4.6% above our estimate of \$2.18bn**, partly because the contribution from Sibneft's equity investments, mainly its 50% interest in Slavneft, was better than expected at \$529mn compared to the \$400mn forecast. The biggest deviation from our estimates came from the amount paid in income tax, as for 2003 Sibneft paid \$184mn in income taxes, an effective tax rate of 11.9% (excluding the one-off gain in 1H03 on the sale of stakes in Orenburgneft and Onaco and also equity income from Slavneft and other affiliates), or 8% in 1H03 and 16% in 2H03. The company said its effective income tax rate in 2003 was 15% when income taxes paid by Slavneft were taken into account.

**This compares to our estimated full-year rate of 15% and statutory rate of 24% and confirms that Sibneft continued to actively employ tax minimization schemes in 2003.** Although the effective tax rate increased in 2H03, we cannot see how Sibneft would be able to continue minimizing its income taxes considering the shutdown of domestic offshore zones from Jan. 1, 2004, and the implications of the Yukos tax case. Hence we are leaving the tax rate estimates in our financial model for future years at the statutory corporate rate of 24%. The company confirmed at the conference call that its effective income tax rate will increase to 20% in 2004.

**Tax savings and improved working capital helped Sibneft record very strong operating cash flow of \$2.52bn**, which was much higher than expected - 21% above our estimate of \$2.1bn. The reported net debt of \$1.48bn at end-2003 was somewhat higher than forecast (\$1.29bn), but Sibneft did reduce its gross debt level from \$2.24bn to \$1.59bn during the year.

## **Changes to forecasts: production, revenues revised lower, but Slavneft to the rescue**

**At the conference call yesterday Sibneft's COO Alexander Korsik confirmed reports the company is reviewing its oil production growth plans for 2004** and will downgrade its output target from 20% to between 11%-13%, which is in line with the 11.2% output growth in 1H04 reported by the Energy Ministry.

**Based on the reported results and management guidance during the conference call, we have adjusted our model for Sibneft to reflect the following:**

- 1) **Reduced forecast production for 2004** from 36.1mn tons (15% y-o-y growth) to 35mn tons (13% y-o-y); production forecasts for future years were also trimmed although the exit 2010 target of 46mn tons was left intact. Accordingly, we have reduced our expectations of 2004F capex from slightly over \$1bn to \$825mn;
- 2) **Reduced our revenue estimates** due to lower expected realizations from domestic product and Siboil sales;
- 3) **Incorporated a slightly higher effective cost of debt:** 9.8% for 2003 vs. 9% expected; 9% for 2004 onwards from 8% expected;
- 4) **Increased materially the expected contribution from equity affiliates** – we now estimate Slavneft's contribution to earnings to amount to \$600mn-\$700mn in 2004-05 compared to \$400mn earlier.

Although the changes in our revenue and production assumptions prompted us to trim our revenue and EBITDA estimates for 2004-05, net income was little affected due to an increase in the expected contribution from Slavneft.

**Revenue, EBITDA forecasts revised lower, but net income largely intact**

In \$mn	Old		New		Change	
	2004F	2005F	2004F	2005F	2004F	2005F
Revenue	8,344	8,262	7,570	7,457	-9%	-10%
EBITDA	3,047	3,065	2,541	2,620	-17%	-15%
Net income (adjusted)	2,023	1,967	1,907	2,010	-6%	2%

Source: Company data Aton estimates

**In fact, Slavneft's higher than expected profitability prompted us to revise the estimated value of Sibneft's 50% interest from \$2.7bn** (which was based on BP's 2003 acquisition of a 25% stake for \$1.35bn) to \$4.06bn. Our new estimate was calculated as expected 2004F net income (due to Sibneft) of \$608mn discounted to perpetuity at 15%; the implied multiples were 6.7-times 2004F earnings, five-times 2004F EBITDA and \$50/bbl of output, very reasonable once Slavneft's growth potential is taken into account.

**The net impact of all our changes was a slight increase in the target price from \$3.3 to \$3.4 a share.** We note that our estimate includes a potential \$1bn liability for 2000-01 tax underpayment, in line with the bill sent to the company by the Tax Ministry earlier this year. Excluding this bill, we estimate Sibneft to be worth \$3.6 a share, or 33% upside potential to its recent close of \$2.7.

## Conclusion

**The results have shown again that Sibneft remains the best managed Russian oil company,** with a very good cost performance in a challenging environment and a proactive response to changing industry dynamics. We were also pleased to see that Sibneft remained the profit center for its core and portfolio shareholders alike as all profits from Slavneft and other investments have flowed through Sibneft's own P&L.

**In 2004-05, we expect Sibneft to continue leading the sector** in terms of cash flow growth and profitability margins. As we noted recently, a large share of Sibneft's revenue (33% vs. roughly 20% at Lukoil and Yukos) comes from domestic/CIS sales, where prices are very strong and which are not subject to the prohibitive new export duty schedules. Also, we expect Sibneft to resume its policy of cash distributions and/or accelerate the search for a strategic partner once the de-merger with Yukos is finalized.

**The continued political uncertainties surrounding the company's principal shareholders and its de-merger with Yukos prevent us from upgrading the stock to a fundamental Buy.** It is also worth remembering that Sibneft's portfolio investors were excluded from the original deal with Yukos, a sign of how management is likely to treat minorities if another merger deal materializes. However, if we were to pick the best "oligarch" stock in Russia based on the historic track record of value creation and distribution, we would certainly pick Sibneft. In the portfolio management context, Sibneft also represents a very healthy alternative to Yukos – it offers similar upside in the event of a positive resolution to the conflict at a fraction of the potential downside.

**Target price calculation for Sibneft**

Total NPV of future FCF, \$mn	14,695
Less: Net debt (cash), \$mn (end 03)	1,485
Less: Minority interest, \$mn	0
Less: 2000-2001 tax liabilities, \$mn	1,000
Plus: Value of Slavneft interests, \$mn	4,056
Total equity value, \$mn	16,266
Common shares outstanding, mn	4,741
Common equivalent shares outst., mn	4,741
<b>Fair value per share, \$</b>	<b>3.4</b>

Source: Company data; Aton estimates

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**Additional information is available on request.**

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**Aton Capital Group**

 27 Pokrovka Street, Bldg. 6  
 Moscow, Russia 105062

 7 (095) 777-8877  
 7 (095) 777-8876, fax  
 aton@aton.ru

 www.aton.ru  
 www.aton-line.ru  
 ATON <GO> (Bloomberg)

**Aton Securities, Inc.**

 60 East 42nd Street  
 Suite 2530  
 New York, NY 10165  
 NASD/SIPC member

 1 (212) 697-6099  
 1 (212) 697-6093, fax  
 sales@AtonSecurities.com

**Sales and Trading**  
 saltrad@aton.ru

Dmitry Starenko, Managing Director

7 (095) 777-8872

**Equity Trading**

Dennis Sarantsev, Director

7 (095) 777-8879

**Institutional Sales**

Matthew Arnold, Director

7 (095) 777-8845

**Private Clients Service**

Alexei Primak, Director

7 (095) 777-8873

**Fixed Income Sales and Trading**

Sergey Sidorov, Director

7 (095) 777-8830

**Aton Securities**

sales@AtonSecurities.com

Michael Jordan, CEO

1 (212) 697-6099

**Sales and Trading**

Courtney Fellowes, Director of sales

1 (212) 697-6099

**Research**

atonres@aton.ru

Steven Dashevsky, Managing Director

7 (095) 777-8832

**Strategy**

 Alex Kantarovich, CFA  
 kantarovich@aton.ru  
 7 (095) 777-8835

**Oil / Gas**

 Steven Dashevsky, CFA  
 dashevsky@aton.ru  
 7 (095) 777-8832

**Utilities**

 Alexander Korneev  
 korneev@aton.ru  
 7 (095) 777-8838

**Economics**

 Peter Westin  
 westin@aton.ru  
 7 (095) 777-8831

 Zarko Stefanovski  
 stefanovski@aton.ru  
 7 (095) 777-8828

**Metals/Industrial**

 Timothy McCutcheon  
 mccutcheon@aton.ru  
 7 (095) 777-8877, ext. 3120

## Alexei Vorobiev

 avorobiev@aton.ru  
 7 (095) 777-8877, ext. 3134

## Dmitry Loukashov, CFA

 loukashov@aton.ru  
 7 (095) 777-8837

**Consumer/Industrial/Banking**

 Alexei Yazikov  
 yazikov@aton.ru  
 7 (095) 777-8877, ext. 3123

**Politics**

 Michael Heath  
 heath@aton.ru  
 7 (095) 777-8877, ext. 3112

**Telecoms/Technology**

 Nadezhda Goloubeva, CFA  
 goloubeva@aton.ru  
 7 (095) 777-8834

**Fixed income**

 Alexey Boulgakov  
 boulgakov@aton.ru  
 7 (095) 777-8877, ext. 3126

 Elena Bazhenova  
 bazhenova@aton.ru  
 7 (095) 777-8829

 Alexei Yu  
 yu@aton.ru  
 7 (095) 777-8877, ext. 4155