

## SOUTH PRIOBSCOYE REMAINS CORE UPSTREAM DRIVER

### More positive following South Priobskoye field visit

**Site visit confirms efficiency of upstream stronghold.** Following our visit to Gazprom Neft (SIBN RX – Buy) last week, we have marginally upgraded our target price to \$7.0/share (from \$6.9/share), implying 30% upside, and we reiterate our Buy recommendation. We visited Gazprom Neft’s South Priobskoye oilfield (the field is licensed to Gazprom Neft’s Khantos subsidiary) with investors and fund managers. South Priobskoye is Gazprom Neft’s biggest oilfield, which in 2009 accounted for 37% of the company’s overall 2P reserves and 30% of total consolidated production (excluding the 50% stake in Tomskneft, 49.8% in Slavneft, and 50% in Salym Petroleum Development). Although South Priobskoye is approaching its production plateau, the company assured us that the utilization of efficient drilling, secondary recovery techniques, and associated gas at the proprietary gas power station will enable robust production to be sustained.

- In line with the company’s guidance, we have incorporated a more aggressive production profile for South Priobskoye, resulting in an 8.3% production increase over our previous forecast at the field this year, a 6.9% rise in 2011, and just over 2% thereafter.
- After our visit to Eurasia Drilling in Kogalym the following day, we learned that Eurasia Drilling won the tender to start drilling at Gazprom Neft’s Ravninnoye oilfield (located to the East of Noyabrskneftegas, a core upstream Gazprom Neft subsidiary), where it will spud two rigs. Our previous forecast for Ravninnoye assumed pilot production from 2015 and commercial production starting in 2017. Our new forecast has commercial production starting in 2012, increasing peak production from 1 mtpa to 1.5 mtpa.
- We have slightly upgraded production at Gazprom Neft Khantos’s Palyanovskya and Zimnee fields.

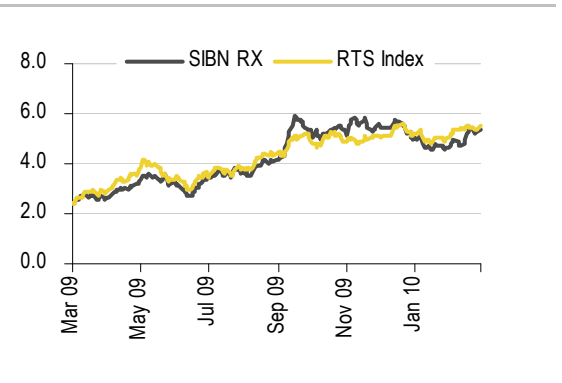
**Key technical takeaways.** Priobskoye is Gazprom Neft’s largest oilfield, covering 30% of consolidated production and 37% of oil reserves:

- The Achimov oil deposits (lower Cretaceous period) are characterized by low stratum permeability. The original permeability was 5 miliDarsi (compared with the nearly 500 miliDarsi permeability of the upper Cretaceous sandstone deposits of most Western Siberian oilfields). The oil’s gravity is 862 kg/cum. The deposits are 2,400-2,500 m deep.
- Gazprom Neft is using an average of 20-24 rigs to drill the wells, employing Eurasia Drilling (EDC), Siberian Service Company (SSC), and in-house Service Drilling Company (SDC). We visited SDC’s rig during the trip. The company told us that it considers SSC and EDC to be more efficient drillers: it takes them 13-15 days to complete one well, while SDC takes up to 17 days. Gazprom Neft drilled 386 wells in 2009, and plans to drill 290 and 285 wells in 2010 and 2011, respectively.

Gazprom Neft		BUY	
SIBN RX		52 wk hi, \$	5.96
Price, \$	5.38	52 wk lo, \$	2.84
Px Target, \$	7.00	Common, mln	4,741
Up/Dn, %	30	Free float, %	4.3
1 m, %	14	ADR(GDR)/Sh. Ratio	5.0
3 m, %	(4)	Pref sh, mln	-
6 m, %	25	MC, \$ mln	25,493
12 m, %	78	EV, \$ mln	33,441
	2009E	2010E	2011E
P/E	8.5	6.8	5.3
EV/EBITDA	6.8	4.6	4.0

Source: RTS, URALSIB estimates

Gazprom Neft, RTS, \$



Source RTS

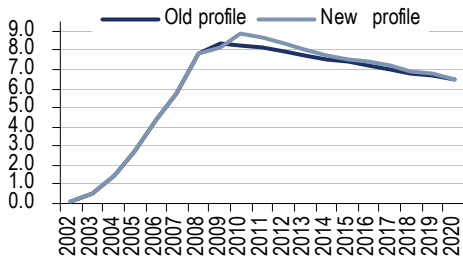
Note: Market data as of 29 March 2010

South Priobskoye Field Visit

- Due to the rock’s low permeability, hydro fracturing operations are applied to all wells: permeability is increased to nearly 50 miliDarsi, while daily flows are 100-120 tons per well (25-75 tons per well without fracturing). The companies employed for the fracturing are Halliburton, CoilFRAC, Trican (Newco Well Service), and CAToil (which we also visited in Kogalym during the trip).
- There are no self-flowing wells; all are equipped with electric submersible pumps.
- The watercut of oil extracted is currently only 20% (compared with an average of 70-80% watercut at LUKOIL’s Kogalym fields and Surgutneftegas’s fields). Thus, electricity usage at Priobskoye is only 90MW pa. The company constructed the first stage of a gas power station last year, comprising four power units of 12 MW each, with total generating capacity utilization of 83%. The second stage of the gas power complex is to be completed in 2012, providing another 48 MW of capacity to cover electricity needs at the field fully.

**Priobskoye Profile Upgraded**

Production, mln tons



Source: Gazprom Neft, URALSIB estimates

**Priobskoye field – Core Gazprom Neft Asset**

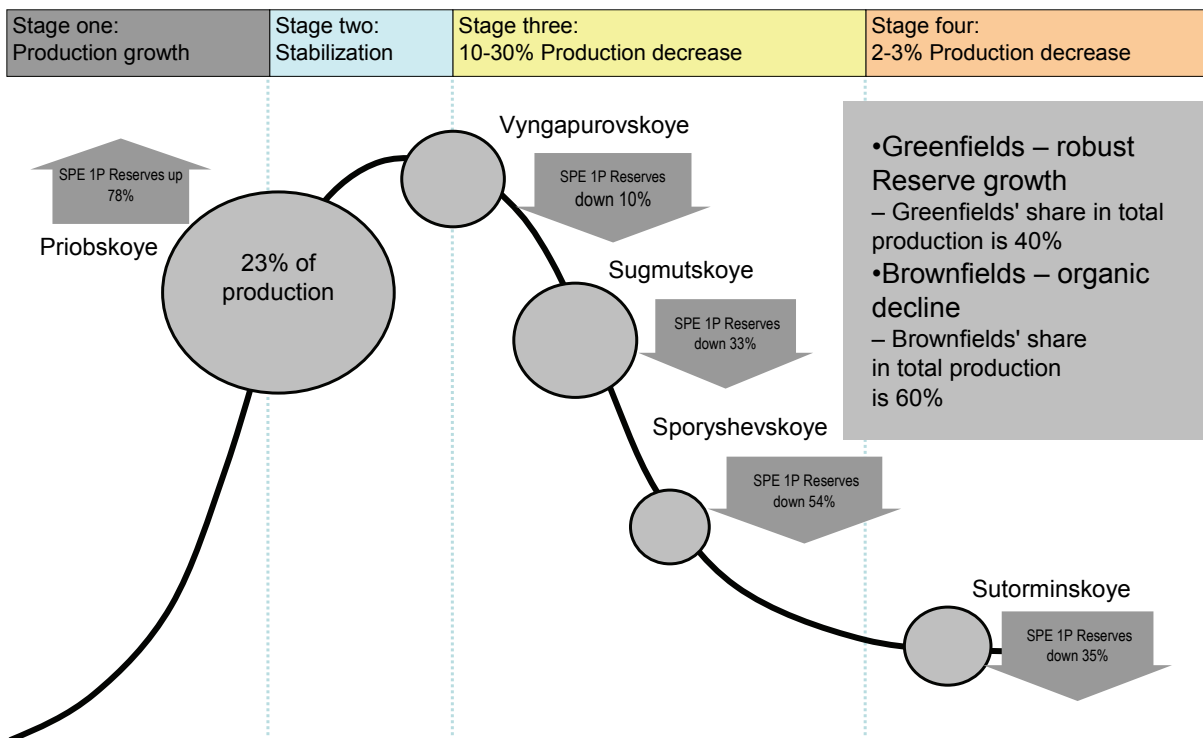
Oil reserves and production

	2008	2009
Oil reserves, mln bbl		
1P	2,103	2,168
2P	589	589
3P	63	63
Oil production, mln tons	7.1	8.2
Oil production, mln bbl	52.1	60.0

Source: Gazprom Neft, URALSIB estimates

**Gazprom Neft Lacks Organic Assets for Near-term Growth: M&As are Positive and Imminent**

Reserve Base versus Production Cycle



Source: Gazprom Neft

**BBB – Best Balanced Balance**

Gazprom Neft Balance Sheet Summary US GAAP, \$ Mln

	2010E	2011E	2012E	2013E	2014E	2015E
Cash and equivalents	268	3,638	5,794	8,109	10,131	12,040
Short term investments	153	153	153	153	153	153
Accounts receivable	680	744	788	782	718	686
Inventories	1,762	1,187	1,242	1,237	1,139	1,103
Other current assets	-	31	35	34	30	28
<b>Total current assets</b>	<b>2,863</b>	<b>5,753</b>	<b>8,011</b>	<b>10,315</b>	<b>12,172</b>	<b>14,010</b>
Long term investments	7,472	8,022	8,622	9,222	9,822	10,422
Oil & gas properties and PP&E, net	15,925	15,044	15,006	14,880	14,793	14,615
Goodwill and intangible assets, net	1,749	1,875	1,933	1,840	1,640	1,530
Other noncurrent assets	190	185	209	205	182	171
<b>Total noncurrent assets</b>	<b>25,336</b>	<b>25,125</b>	<b>25,770</b>	<b>26,146</b>	<b>26,437</b>	<b>26,738</b>
<b>Total assets</b>	<b>28,199</b>	<b>30,878</b>	<b>33,782</b>	<b>36,462</b>	<b>38,609</b>	<b>40,747</b>
debt	2,148	2,148	2,148	2,148	2,148	2,148
Accounts payable	1,283	1,327	1,362	1,363	1,263	1,252
Short term income and other taxes payable	798	907	981	973	881	825
Other current liabilities	416	416	416	416	416	416
<b>Total current liabilities</b>	<b>4,645</b>	<b>4,798</b>	<b>4,907</b>	<b>4,899</b>	<b>4,708</b>	<b>4,641</b>
Long-term debt	4,162	4,162	4,162	4,162	4,162	4,162
Assets retirement obligation	410	387	386	383	381	376
Other long term liabilities	387	509	556	550	496	465
<b>Total long term liabilities</b>	<b>4,959</b>	<b>5,058</b>	<b>5,104</b>	<b>5,095</b>	<b>5,039</b>	<b>5,003</b>
Minorities	2,506	2,506	2,506	2,506	2,506	2,506
<b>Total liabilities</b>	<b>12,110</b>	<b>12,362</b>	<b>12,518</b>	<b>12,501</b>	<b>12,253</b>	<b>12,150</b>
Capital (Common and preferred shares)	2	2	2	2	2	2
Treasury stock	(45)	(45)	(45)	(45)	(45)	(45)
Additional paid-in capital	573	573	573	573	573	573
Retained earnings	15,559	17,986	20,734	23,431	25,826	28,067
<b>Total shareholders equity</b>	<b>16,089</b>	<b>18,516</b>	<b>21,264</b>	<b>23,961</b>	<b>26,356</b>	<b>28,597</b>
<b>Total liabilities and equity</b>	<b>28,199</b>	<b>30,878</b>	<b>33,782</b>	<b>36,462</b>	<b>38,609</b>	<b>40,747</b>

Source: Company, URALSIB estimates

**Efficient and Solid**

Gazprom Neft Income Statement US GAAP, \$ Mln

	2010E	2011E	2012E	2013E	2014E	2015E
Refined product, oil & gas sales	25,859	28,285	29,934	29,730	27,299	26,056
Other sales	1,361	1,489	1,575	1,565	1,437	1,371
<b>Total revenues</b>	<b>27,220</b>	<b>29,773</b>	<b>31,510</b>	<b>31,295</b>	<b>28,736</b>	<b>27,427</b>
transportation)	8,554	8,849	9,083	9,085	8,421	8,348
Exploratory expenses	138	138	163	161	161	150
DD&A	3,258	3,098	3,124	3,121	3,120	3,043
SG&A	1,297	1,241	1,164	1,161	1,099	1,062
Taxes other than income tax	9,691	10,864	11,688	11,604	10,530	9,865
Costs of other sales	250	250	250	250	250	250
Other one-off expenses	-	-	-	-	-	-
<b>Operating profit</b>	<b>4,032</b>	<b>5,334</b>	<b>6,040</b>	<b>5,912</b>	<b>5,156</b>	<b>4,710</b>
<b>EBITDAX</b>	<b>7,427</b>	<b>8,569</b>	<b>9,326</b>	<b>9,195</b>	<b>8,436</b>	<b>7,903</b>
<b>EBITDA</b>	<b>7,290</b>	<b>8,432</b>	<b>9,163</b>	<b>9,033</b>	<b>8,276</b>	<b>7,753</b>
Income (loss) from equity affiliates	500	550	600	600	600	600
Other non-operating items	216	266	316	316	316	378
<b>interest &amp; extraordinary items</b>	<b>4,748</b>	<b>6,151</b>	<b>6,956</b>	<b>6,828</b>	<b>6,072</b>	<b>5,688</b>
Income tax	950	1,230	1,391	1,366	1,214	1,138
<b>extraordinary items</b>	<b>3,798</b>	<b>4,920</b>	<b>5,565</b>	<b>5,463</b>	<b>4,858</b>	<b>4,550</b>
Minorities	(68)	(68)	(68)	(68)	(68)	(68)
<b>Income before extraordinary items</b>	<b>3,730</b>	<b>4,852</b>	<b>5,497</b>	<b>5,395</b>	<b>4,790</b>	<b>4,482</b>
principles)	-	-	-	-	-	-
<b>Net income</b>	<b>3,730</b>	<b>4,852</b>	<b>5,497</b>	<b>5,395</b>	<b>4,790</b>	<b>4,482</b>

Source: Company, URALSIB estimates

## Robust Cash Flow Growth

Gazprom Neft Cash Flow US GAAP, \$ Mln

	2010E	2011E	2012E	2013E	2014E	2015E
Net income	3,730	4,852	5,497	5,395	4,790	4,482
DD&A	3,258	3,098	3,124	3,121	3,120	3,043
Exploration expenses	138	138	163	161	161	150
Change in working capital	3,486	1,497	840	865	854	874
<b>Net cash from operating activities</b>	<b>10,612</b>	<b>9,585</b>	<b>9,623</b>	<b>9,542</b>	<b>8,924</b>	<b>8,549</b>
Capex	(3,109)	(3,099)	(3,507)	(3,385)	(3,369)	(3,155)
Other investment activities	(8,103)	(3,116)	(3,961)	(3,842)	(3,534)	(3,485)
<b>Net cash from investing activities</b>	<b>(11,212)</b>	<b>(6,215)</b>	<b>(7,467)</b>	<b>(7,227)</b>	<b>(6,903)</b>	<b>(6,640)</b>
Proceeds (repayments) of debt	-	-	-	-	-	-
Other financing activities	-	-	-	-	-	-
<b>Net cash from financing activities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net (decrease) increase in cash</b>	<b>(600)</b>	<b>3,370</b>	<b>2,156</b>	<b>2,315</b>	<b>2,022</b>	<b>1,909</b>
Cash and cash equivalents at start of year	868	268	3,638	5,794	8,109	10,131
<b>Cash and cash equivalents at end of year</b>	<b>268</b>	<b>3,638</b>	<b>5,794</b>	<b>8,109</b>	<b>10,131</b>	<b>12,040</b>

Source: Company, URALSIB estimates

## Leading Efficiency...mind the Future

Financial ratios

	2010E	2011E	2012E	2013E	2014E	2015E
<b>Profitability ratios</b>						
Operating margin, %	14.8	17.9	19.2	18.9	17.9	17.2
EBITDA margin, %	26.8	28.3	29.1	28.9	28.8	28.3
EBITDAX margin, %	27.3	28.8	29.6	29.4	29.4	28.8
Net margin, %	13.7	16.3	17.4	17.2	16.7	16.3
<b>Liquidity ratios</b>						
D/E ratio, %	39	34	30	26	24	22
Total deb/EBITDA	0.87	0.75	0.69	0.70	0.76	0.81
<b>Efficiency ratios</b>						
ROACE, %	16.5	22.1	25.2	24.2	20.7	18.7
ROE, %	23.2	26.2	25.9	22.5	18.2	15.7
ROA, %	13.2	15.7	16.3	14.8	12.4	11.0
<b>Operating efficiency ratios</b>						
Sales per barrel (\$/bbl)	106	114	118	115	105	101
EBITDA per barrel (\$/bbl)	28	32	34	33	30	28
Net income per barrel (\$/bbl)	15	19	21	20	17	16

Source: Company, URALSIB estimates

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