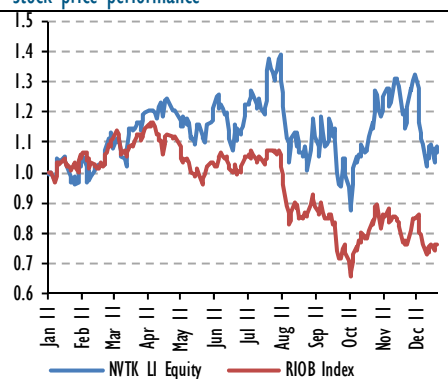


NOVATEK: new valuation, new drivers, more value



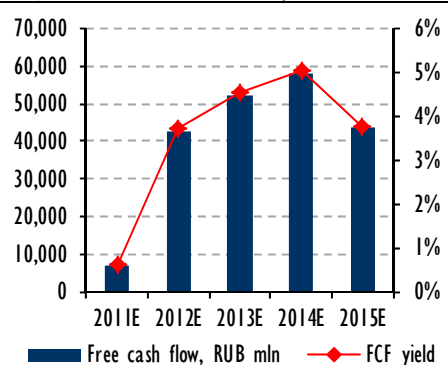
NVTK	OVERWEIGHT
Target price (new), \$	185.0
Target price (old), \$	170.7
Change	8%
Closing price, \$ (Dec 27, 2011)	130.5
Upside potential	42%

Stock price performance



Source: Bloomberg, Gazprombank estimates

Projected free cash flow and FCF yield



Source: Bloomberg, Gazprombank estimates

NOVATEK has recently presented its new corporate strategy, and we roll forward our target price for the company's shares to the end of 2012. We increase the TP by 8% to \$18.5 per share (\$185 per GDR) from the previous target of \$17.07 per share (\$170.7 per GDR). Our new TP implies a 43% upside from the current level (42% for GDR), and we reiterate OVERWEIGHT recommendation. We still view the company as one of the few growth stories in the Russian oil & gas sector. We point to expansion prospects on the domestic market, changes in the liquids sales structure and new partners in Yamal-LNG project as the main growth drivers in 2012.

New upgraded forecasts of gas and liquids production. NOVATEK has increased its gas production guidance for 2012 by 5% to 68 bcm from the previous guidance of 65 bcm. In 2020, the company expects to produce 112.5 bcm. Liquids production is anticipated to double by 2015, to 8.6 mln tonnes from 4.2 mln tonnes in 2011. The liquids output is estimated at 13.3 mln tonnes in 2020, an impressive 217% growth from 2011, or CAGR of 14%. At its Strategy day, NOVATEK disclosed plans to produce about 30 bcm of gas in 2020, or more than a quarter of its estimated production, at its new fields at Yamal Peninsula acquired in 2011. These fields are the main driver of changes in our model: we have upgraded EBITDA forecast for 2017-2020 by 45% from earlier models.

New capex forecast for 2011-2020 assumes inexpensive increment in production. We estimate the total capex in 2011-2020 at RUB 860 bln, including Yamal-LNG project. This implies the cost of added production of just \$58.4 of the cumulative capex per each additional boe of production, 38% less than in 2006-2010. We think that a larger part of capex would be made in 2011-2015, but even in this high-spending period, the cost of added production in 2015 would be \$102.7 per boe. This growth is significantly below inflation, or just by 9% more than the cost of additional output in 2006-2010.

Domestic gas market expansion with increase in end-customer base may be the main driver for margins. According to the company, it plans to increase its domestic gas sales by 21%, from 59.5 bcm in 2012 to 72 bcm in 2015. At the same time, end-customer sales should increase by 34%, from 44 bcm to 58 bcm in 2015, while sales to traders would decrease by 14% over the same period. The mere change in the gas sales structure would increase the company's gas netbacks by 10-12% in 2012 alone, and further lift them in at least 10% annual increments in 2013-2015. The changes in domestic gas sales, coupled with the expected 15% annual increase in domestic gas prices, would drive EBITDA margin in 2012-2013 to 53% from 51% in 2011.

Gas condensate fractionation unit should overhaul the liquids production structure in 2013. In 4Q12, NOVATEK is set to launch the new condensate fractionation unit in Ust-Luga, which would result in major structural changes in liquids sales of NOVATEK. Instead of gas condensate sales, which would account for 72% of the total liquids revenues in 2011, NOVATEK would commence exports of oil products, namely naphtha, diesel, jet fuel and heating oil. According to NOVATEK, it would cut the company's export duty payments by 10% in 2013. We also estimate that the product basket produced at Ust-Luga refinery may give NOVATEK an 8% price premium as compared to gas condensate sales, which would provide additional support to its margins.

Yamal-LNG project looks a done deal with year-round navigation. We expect the project FEED to be completed, and new partners to be attracted, by 2Q12. In the presentation, NOVATEK cited research results, which had confirmed that Yamal-LNG project may provide all-season products distribution. The company said that the FEED of Yamal-LNG project should be completed by the end of 2Q12. We think that agreements with prospective partners should be signed before the FEED completion, providing short-term drivers in 1H12.

Key financial indicators, RUB mln

	2010	2011E	2012E	2013E	2014E	2015E
Revenue	117,024	170,197	211,306	256,492	322,293	378,907
EBITDA	58,560	87,206	113,434	136,528	160,956	181,049
EBITDA margin	50.0%	51.2%	53.7%	53.2%	49.9%	47.8%
Net profit	40,533	64,663	83,757	99,951	115,805	131,123
Net margin	35%	38%	39%	39%	37%	36%

Source: company, Gazprombank estimates

NVTK	OVERWEIGHT
Target price, \$	185.0
Closing price, \$ (Dec 27, 2011)	130.5
Upside potential	42%

No. of shares outstanding, mln	3,036
Free float	30%
Market capitalization, \$ mln	39,623
Net debt, \$ mln	2,543
Minority interest, \$ mln	2
EV, \$ mln	42,168
52-week high, \$	164.0
52-week low, \$	101.0

Source: Bloomberg, company

Investment summary

We roll forward our target price for shares of NOVATEK to the end of 2012, incorporating the update provided by the company on its recent strategy day into our valuation. We reiterate the OVERWEIGHT recommendation and increase the TP to \$18.5 per share (\$185.0 per GDR), which implies a 43% upside from the current price level (42% for GDR). We still view NOVATEK as one of the few growth stories in the Russian oil & gas industry, with the highest projected revenues and EBITDA growth rates among Russian O&G majors. We point to the recently acquired new upstream assets, which push up our long-term projections of the company's financials. The release of the FEED for Yamal-LNG project, expansion on the domestic market and changes in liquids distribution scheme are the main drivers for NOVATEK's financials and its share price over the next 12 months.

NOVATEK's revenues and EBITDA will continue to grow at CAGR of 16% in 2011-2015 in our estimates. In 2011, the company's EBITDA may increase by 50% YoY, which would be the highest growth rate among Russian oil and gas majors. Although we do not expect the company to show the same growth rate beyond 2012, we estimate CAGR of revenues and EBITDA for the next 5 years at 16%, the strongest among Russian oil and gas majors. This makes us believe that the high multiples of NOVATEK are well justified.

New Yamal fields are not accounted by the market. At its Strategy day, NOVATEK disclosed plans to produce about 30 bcm of gas in 2020, or more than a quarter of its estimated production, on its new Yamal Peninsula fields acquired in 2011. These are the main driver of changes in our model: we have upgraded our EBITDA forecast for 2017-2020 by 45% from earlier models.

There are still plenty of short-term drivers: expansion at the domestic market, liquids sales upgrade, completion of Yamal-LNG FEED. In 2012, NOVATEK is expected to increase its share of end-customer gas sales to 73% from about 55% in 2011, which would drive its gas netbacks up by at least 10% YoY in 2012. We expect NOVATEK to commission its gas condensate fractionation unit in Ust-Luga by the end of 2012. This should completely change the company's liquids sales structure, making it higher value-added, less taxed and more flexible in terms of marketing. We also expect the company to complete FEED of Yamal-LNG project and announce new foreign partners in the project in 1H12.

Main assumption changes

Production

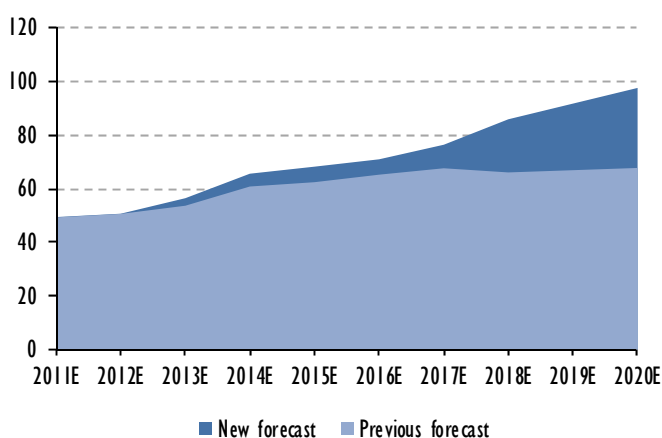
We have upgraded our gas production forecast for 2020 by 30 bcm to 98 bcm.

We have upgraded our gas and liquids production assumption, which now accounts for the new upstream projects - mainly Utrenneye and Geofyzicheskoye fields. By 2020, they should contribute a quarter of NOVATEK's production, or 30 bcm. We have also updated production assumptions for Sibneftegaz, Sever Energia, Yamal LNG and other new projects of the company. As a result of that, we have upgraded our production forecast for 2020 by 30 bcm to 98 bcm. We only account for production of those entities which NOVATEK would be able to consolidate.

Liquids output projection for 2020 has been more than doubled to 10.2 mln tonnes.

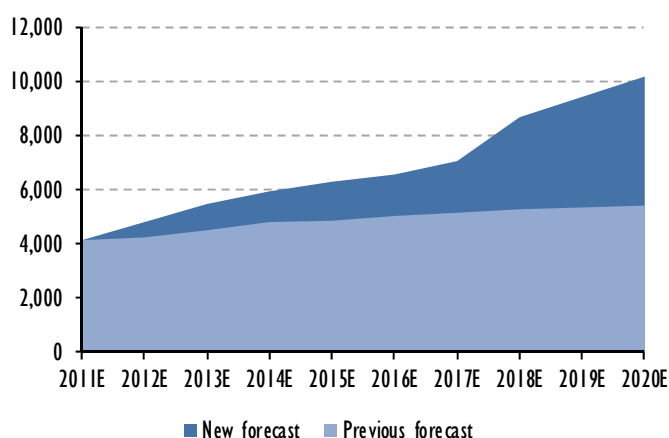
We have also upgraded our liquids production estimates for 2015 by 1.4 mln tonnes, from 4.9 mln tonnes to 6.3 mln tonnes. Our estimates for 2020 have almost doubled from 5.4 mln tonnes to 10.2 mln tonnes.

Forecast of gas production, bcm



Source: company, Gazprombank estimates

Forecast of liquids production, '000 tonnes



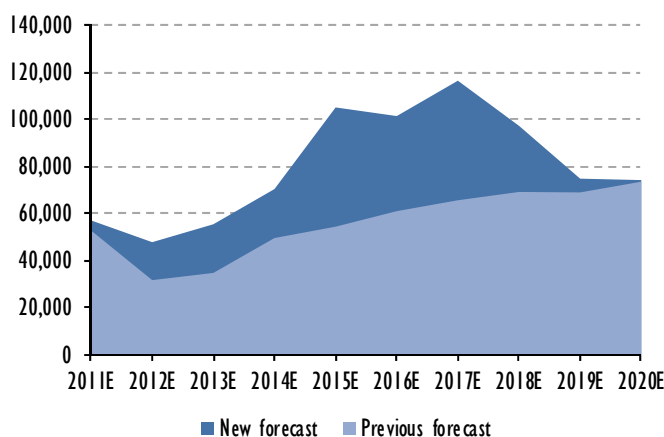
Source: company, Gazprombank estimates

Capex

The new capex forecast for 2011-2020 is RUB 810 bln.

We have significantly upgraded our capex forecast in order to account for the massive investments in new fields NOVATEK is to perform in 2012-2017. Our total capex forecast for 2011-2020 has been upgraded by 44% to RUB 810 bln from the previous RUB 562 bln. The capex peak is expected in 2017 at RUB 116 bln.

Projected capex, RUB mln



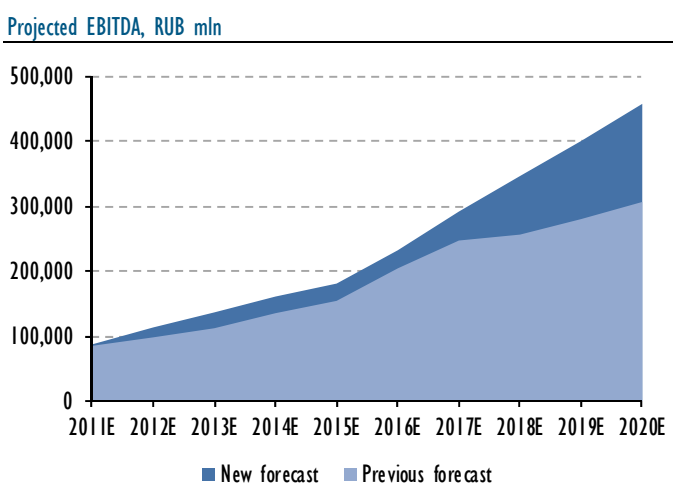
Source: company, Gazprombank estimates

EBITDA

Our cumulative EBITDA forecast for 2011-2020 has been upgraded by 28% to RUB 2,408 bln.

We anticipate EBITDA growth rates of NOVATEK basically in line with its production growth. Given the projected increase in domestic gas prices and the changes in the liquids sales mix of the company, we are not looking for EBITDA to fall below 45% in the long term. However, our changes in EBITDA projections mainly pertain to 2017-2020, when the company is expected to commence gas production at its new projects, which was not accounted for in our previous model.

We upgrade our cumulative EBITDA projection for 2011-2020 by 28% to RUB 2,408 bln. We note that 78% of that increase are projected for 2017-2020.

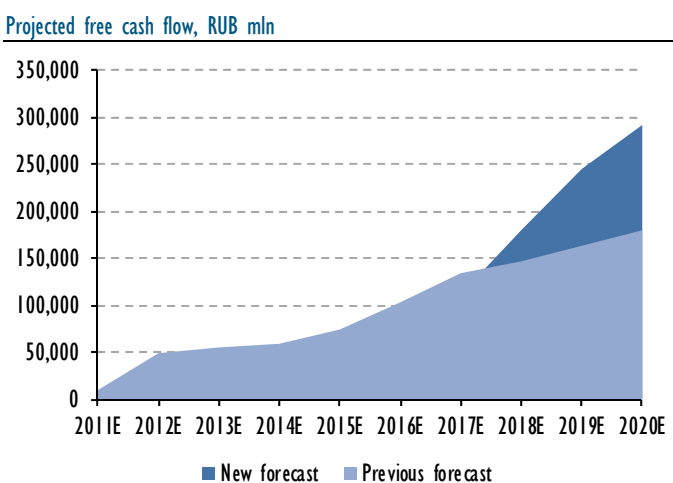


Source: company, Gazprombank estimates

Free cash flow

Undiscounted FCF estimate for 2011-2020 has been raised by 12%.

As NOVATEK's capex will peak in 2015-2017, our pre-2018 FCF projections remained almost unchanged, as extra capex should offset additional operating cash flow in 2011-2017. At the same time, we have higher post-2017 free cash flow forecast on the back of the significant increase of EBITDA forecast for 2017-2020. We upgrade our undiscounted FCF projections for 2011-2020 by 12% only, or by RUB 125 bln, which results in a 8% upgrade in target price.



Source: company, Gazprombank estimates

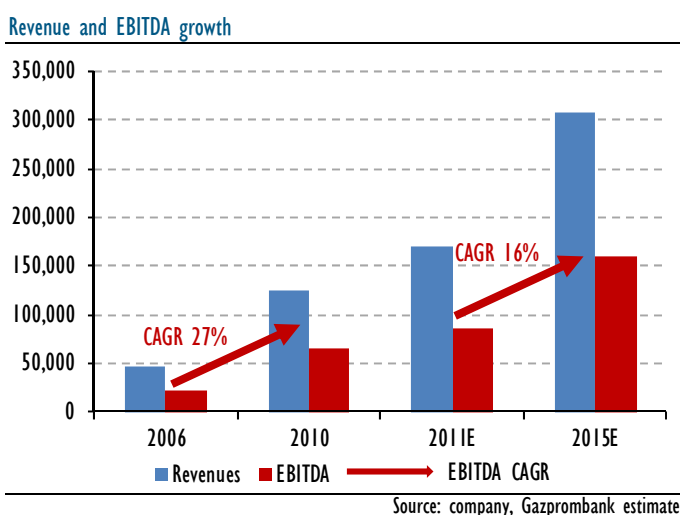
Risks: Investor's FAQ on NOVATEK.

Q. Investors argue that growth has slowed down. Are the high multiples still justified?

A. Yes, because growth is still here, and it remains the fastest in the Russian oil and gas sector.

Growth continues despite the slowdown and should remain sustainable.

After NOVATEK provided its tiny production growth guidance for 2012 (just 7-8% YoY as compared to more than 35% YoY in 2011) investors began to express concerns that the company may be too expensive given the single-digit growth rates. Well, in fact we expect the revenue and EBITDA growth rates in 2012-2015 to be lower than those seen in 2006-2010. However, we expect revenues and EBITDA to grow with CAGR of 16% in 2011-2015. Taking into account the high base effect, the revenues in 2011 would be 260% higher than in 2005. As this growth rate would be the highest among Russian oil and gas majors, we still believe that the high multiples are justified.



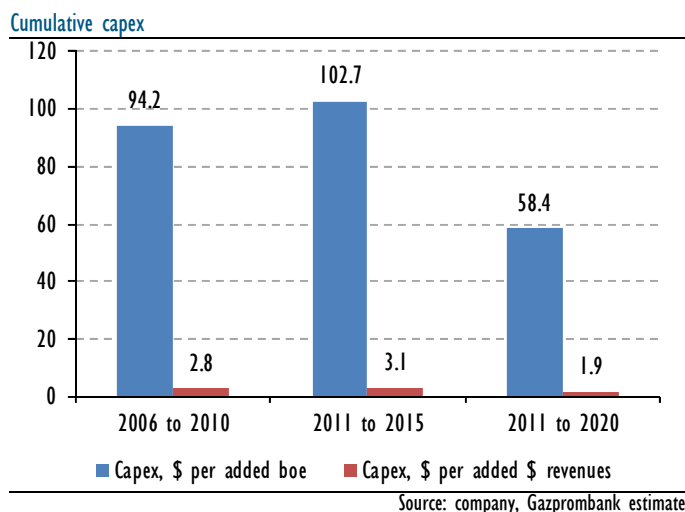
Q. Capex figures are huge. Maybe growth has become more expensive?

A. No, the specific capex per each additional boe of production in 2011-2015 would be just 9% higher, while if taken for the entire forecast period 2011-2020, it appears 38% lower.

Capex figures are huge, but in relative terms they look decent.

Looking at the company's guidance of the total capex for 2011-2020, one may argue that its growth has become expensive. In total, NOVATEK plans to spend RUB 800 bln in 2011-2020, excluding Yamal-LNG, and about RUB 870 bln if this project is taken into account. This may be compared to approximately RUB 189 bln spent in 2006-2010, including acquisitions.

We argue that the growth is not expensive. In our estimates, each extra boe of production in 2015 as compared to 2011 will cost NOVATEK \$102.7. This is just 9% higher than the company paid for each boe of added production in 2010 as compared to 2006, and this is less than inflation. Moreover, the added production in 2020 as compared to 2011 would cost just \$58.4 per boe, which is almost 39% less than in 2010-2006.



Q. Other risks – are there any?

A. No, not specifically for NOVATEK. Although we admit the fact that Russia is an emerging market and any changes in the market environment may move prices, we do not think that NOVATEK is more exposed to environment risks than any other Russian oil and gas company.

All current business flows of NOVATEK, as well as its resources for growth, are well secured from both local and macro risks. We expect NOVATEK to increase its share of end-customers in 2012 to 75% from about 57% in 2011. The company's reserve life is 30 years (based on production figures for 2010), which is one of the highest in the Russian oil and gas industry. As much as 35% of revenues for 2011 would come from exports of liquids, and this revenue is not ruble-denominated. NOVATEK has clear and transparent corporate structure, with the parent company of the group being the final beneficiary of all profits and cash flows. The low production enable the company to have the highest EBITDA margin in the sector. We argue that all these factors make NOVATEK one of the least risky stories. In order to account for the global markets volatility and Russian country-specific risks we add 3 pps to our estimated cost of equity, which, together with an approximately 1 pps increase in the estimated cost of debt, results in increase of WACC from 9.3% used in our previous update on the company to 12.2%.

NOVATEK is a market-oriented transparent company with a large customer base, which makes the company immune to Russia-specific environment risks.

Q. NOVATEK is focused on the domestic market. What if domestic gas prices will not grow by 15% a year as you model?

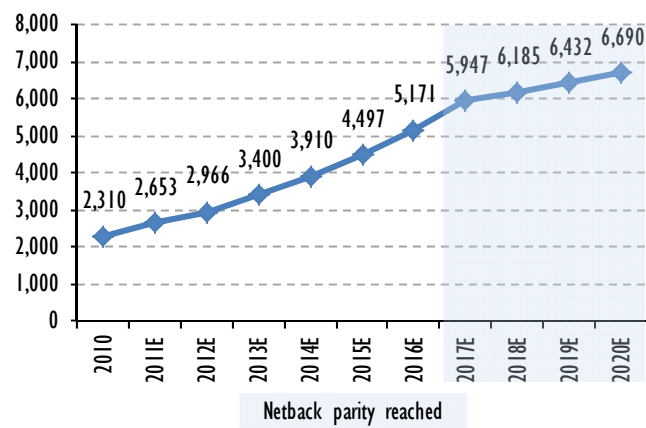
A. We would argue that NOVATEK's valuation, thanks to well-structured revenues and expenses of the company, is less sensitive to changes in macroeconomic factors than that of any other Russian oil and gas company.

NOVATEK has historically had a stable share of liquids sales in the total revenues (about 30-37%), and we believe that it will not decrease in the long term. More than 90% of liquids are exported. Moreover, in 4Q12, the company plans to commence operations at its Ust-Luga gas condensate fractionation unit, which would completely change the structure of the company's liquids sales. We expect NOVATEK to sell almost no gas condensate, and shift its sales mix towards naphtha, kerosene, diesel fuel and heating oil. We also underline that we project the netback parity to be only hit in 2017, while the government's current plan is to reach it in 2014, so we are

Business diversification and high exposure to the liquids segment are a good insurance against a plunge in domestic gas prices.

more conservative in our domestic gas price forecasts.

Forecast of gas price for end-customers of NOVATEK, RUB per mcm



Source: company, Gazprombank estimates

Valuation update

Our DCF-based target price is \$18.5 per share (\$185.0 per GDR), which implies a 43% upside (42% upside for GDRs).

We roll forward our target price for NOVATEK to the end of 2012 and increase it to \$18.5 per share (\$185.0 per GDR), which implies a 43% upside (42% for GDR). We reiterate our recommendation to OVERWEIGHT the shares of NOVATEK.

WACC calculation

We use WACC of 12.2%.

For the purposes of DCF valuation of NOVATEK, we use WACC of 12.2%. We calculate NOVATEK's cost of equity as the sum of risk-free rate, which we define as the yield of UST 10 of 2.0% and Russia-specific equity risk premium of 8% obtained as the sum of 5% equity risk premium and 3% Russian country-specific risk premium, plus specific 4% risk premium to account for market volatility. We calculate the company's cost of debt as the after-tax rate for NOVATEK-15 eurobonds.

WACC calculation

Risk-free rate: 10-year US Treasury yield, 1M average	2.0%
Company and country-specific risk premium	12.0%
Cost of equity	14.0%
After tax cost of debt	4.5%
Weight of equity	81.7%
Weight of debt	18.3%
WACC	12.2%

Source: Bloomberg, Gazprombank estimates

We leave terminal growth rate unchanged at 2%.

DCF valuation

We use the terminal growth rate of 2%, accounting for Yamal-LNG project, as well as other fields of the company on Yamal Peninsula.

DCF valuation model summary, RUB mln

	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues	117,024	170,197	211,306	256,492	322,293	378,907	481,657	605,009
Operating costs (inc. purchases, ex. DD&A)	(61,761)	(82,991)	(97,872)	(119,964)	(161,337)	(197,858)	(249,333)	(313,192)
EBITDA	55,263	87,206	113,434	136,528	160,956	181,049	232,324	291,817
EBIT	48,647	78,771	102,911	123,548	144,931	161,303	207,339	260,633
Profit tax	(9,405)	(18,632)	(24,160)	(28,848)	(33,437)	(34,776)	(46,455)	(58,086)
Capex (inc. acquisitions)	(69,245)	(57,156)	(47,894)	(55,486)	(70,449)	(105,133)	(101,472)	(116,429)
Changes in working capital	(4,210)	(8,704)	(2,606)	(3,983)	(6,083)	(5,759)	(10,561)	(11,769)
DD&A	6,616	8,435	10,524	12,980	16,025	19,746	24,985	31,184
Interest expense	161	4,225	4,706	4,951	4,011	4,296	3,820	3,392
Disposals	1,173	—	—	—	—	—	—	—
Other adjustments	(184)	188	(753)	(753)	3,262	3,803	3,441	3,116
Free cash flows	(26,447)	7,126	42,727	52,408	58,260	43,480	81,097	112,041

Source: Gazprombank estimates

DCF valuation model summary, RUB mln

NPV	631,601
Perpetual growth rate	2.0%
Terminal value	1,041,454
Net debt	56,983
Target value	1,616,071
Common shares out, mln	3,036
Target price, RUB	573.48
Target price, \$	18.5

Source: Gazprombank estimates

Peer group valuation

NOVATEK remains expensive – and this is still justified

Although DCF valuation is our preferred method, we also provide peer group multiples comparison for the sake of completeness.

We compare NOVATEK with Gazprom, the only listed gas peer of NOVATEK in Russia, with Russian integrated oil companies, and with international oil and gas majors. We use EV/EBITDA, P/E, EV/Proven reserves multiples and the free cash flow yield. We use our estimates for NOVATEK and Gazprom multiples and Bloomberg consensus projections for other companies.

We note that both on EV/EBITDA and P/E, NOVATEK trades with significant premiums to its Russian peers. On EV/EBITDA 2012E, NOVATEK is valued with a 352% premium to Gazprom, 242% premium to Russian oil majors and 197% premium to international majors. On P/E 2012E, the picture is similar: respective premiums amount to 472%, 196%, and 95%.

NOVATEK is NOT expensive on EV/Reserves.

However, the situation is quite different if we look at EV/Reserves and FCF yield comparison. On EV/Reserves, NOVATEK is traded with a premium to Gazprom only, while it is fairly valued as compared to Russian oils, and it trades with a 75% discount to international majors. We attribute that to the recent acquisitions of NOVATEK and think that this supports our key idea: the potential of Yamal LNG reserves has not yet priced in yet.

On the free cash flow yield, NOVATEK looks overvalued on multiples for 2010 and 2011 (estimated), but only because of acquisitions spending. We note that the FCF yield less acquisitions is in line with both Russian oils and international majors. We also note that the company's estimated FCF yield for 2012 (5%) is 3 pps less than both Russian oils and international majors have, so NOVATEK's premium looks significantly smaller, based on FCF generation ability.

NOVATEK multiple comparison

	Market cap \$ mln	EV/EBITDA			P/E			EV/ Reserves \$/boe	FCF Yield, %			
		2010	2011E	2012F	2010	2011E	2012F		2010	2011E	2012F	
Russian gas companies												
Gazprom	128,556	3.6	2.7	2.5	5.2	4.0	2.9	1.4	6%	7%	8%	
NOVATEK	36,815	21.0	13.0	11.3	44.9	27.7	16.6	4.2	(2%)	3%	5%	
Average		12.3	7.8	6.9	25.1	15.9	9.8	2.8	4%	5%	7%	
Russian vertically integrated companies												
Bashneft	8,932	3.6	3.0	2.9	7.8	6.6	5.5	5.3	2%	11%	11%	
Gazprom neft*	22,058	4.2	2.9	3.3	6.8	4.3	5.4	3.4	9%	6%	9%	
Lukoil	44,605	3.4	2.7	2.9	5.0	3.8	4.2	3.1	12%	9%	9%	
Rosneft	71,070	4.9	4.1	4.7	6.8	5.5	6.7	4.0	7%	7%	4%	
Surgutneftegaz	32,151	2.2	1.6	1.9	8.0	5.7	6.8	1.9	7%	7%	8%	
Tatneft	10,932	4.2	2.9	2.9	6.0	4.2	4.3	2.0	(6%)	2%	5%	
TNK-BP Holding	45,972	4.8	3.6	4.1	7.1	5.2	6.2	4.6	7%	7%	7%	
Average		3.9	3.0	3.3	6.8	5.0	5.6	3.5	5%	7%	8%	
International vertically integrated companies												
BP	135,108	3.9	3.5	3.5	6.5	6.3	6.3	9.0	(3%)	8%	10%	
Chevron	215,490	4.9	3.6	3.7	11.6	7.7	8.4	19.5	6%	6%	6%	
ConocoPhillips	107,214	4.7	4.4	4.6	12.2	8.9	9.9	14.8	6%	7%	8%	
ExxonMobil	421,126	5.9	4.5	4.6	14.3	10.1	10.9	19.1	5%	6%	8%	
Repsol YPF	28,617	3.6	3.8	3.4	9.4	9.8	8.1	19.8	(0%)	3%	5%	
Royal Dutch Shell	222,454	4.8	3.6	3.6	12.0	8.3	7.9	21.7	(0%)	6%	8%	
Total	119,666	3.6	3.2	3.2	8.4	7.8	7.7	13.3	4%	6%	8%	
DM average		4.5	3.8	3.8	10.6	8.4	8.5	16.8	2%	6%	8%	
NOVATEK premium/discount to												
Gazprom	–	483%	381%	352%	763%	593%	472%	200%	–	–	–	
Russian oils	–	438%	333%	242%	560%	454%	196%	20%	–	–	–	
International majors	–	367%	242%	197%	324%	230%	95%	-75%	–	–	–	

Source: Bloomberg, Gazprombank estimates

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