

OAO Novatek

Update

Ratings

Foreign Currency	
Long-Term IDR	BBB-
Senior unsecured	BBB-
Local Currency	
Long-Term IDR	BBB-
National	
Long-Term Rating	AA+(rus)
Senior unsecured	AA+(rus)
Novatek Finance Limited	
Senior unsecured	BBB-

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable
National Long-Term Rating	Stable

Financial Data

OAO Novatek	31 Dec 2011	31 Dec 2010
Revenue (RUBm)	161,541	109,559
Operating EBITDA (RUBm)	88,917	56,200
Operating EBITDA Margin (%)	55.0	51.3
Funds From Operations (RUBm)	73,058	46,954
Cash Flow From Operations (RUBm)	68,510	42,744
Free Cash Flow (RUBm)	26,803	-28,943
FFO Gross Interest Coverage (x)	17.9	21.4
Total Debt with Equity Credit (RUBm)	95,478	72,226
FFO Gross Adjusted Leverage (x)	1.47	1.23

Related Research

[Rating Oil and Gas Production Companies \(August 2012\)](#)

[2012 Outlook: EMEA Oil and Gas \(December 2011\)](#)

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Nortgas Acquisition Broadly Positive: Fitch Ratings affirmed OAO Novatek's investment-grade ratings in November 2012, following the announcement by Novatek that it will acquire a 49% stake in ZAO Nortgaz. Fitch views the acquisition as enhancing the company's domestic business profile. The transaction is likely, however, to see leverage metrics breach the parameters Fitch has set out as likely to trigger a downgrade if sustained over the next 12 to 18 months.

Little Additional Debt Headroom: Fitch forecasts Novatek's funds from operations (FFO) adjusted gross leverage ratio will exceed the agency's current negative rating guideline of 2x in 2012, if the transaction completes this year, but expects it to fall to around 1.7x in 2013-2014 following a gradual repayment of the company's debt. Fitch expects the company's FFO interest coverage to fall below the agency's current negative rating guideline of 10x in 2013, but to improve to 10x-12x in 2014-2015.

Yamal Could be Transformative: Novatek occupies a strategic position in the gas-rich Yamal region, where it has plans to develop liquefied natural gas (LNG) production in the medium term. The company's scale relative to peers is currently a limiting factor for the rating. This may change once Yamal production comes on line.

Yurkharovskoye Production Key Concern: The future performance of the Yurkharovskoye field will be particularly important to increasing Novatek's production levels. Failure to maintain the production of the field in the medium term may lead to downward pressure on Novatek's ratings.

Rising Natural Gas Prices: Novatek continues to benefit from the government's plan to liberalise the price of natural gas sold on the Russian domestic market by 2015-2018. Fitch expects domestic gas prices in Russia to increase by around 15% per year to 2015 implying relatively low price risk for the company. The agency also believes that the expected rising tax burden on independent gas producers will be fully offset by increasing domestic gas prices.

What Could Trigger a Rating Action

Deteriorating Financial Profile: Novatek could be downgraded if its financial metrics undergo a sustained deterioration, possibly from additional acquisitions in 2013, making key cash flow and other credit ratios incommensurate with the current rating level. Novatek's business risk is low, except for execution risk on Yamal LNG.

Improved Business Profile: Expanded upstream business operations with a larger production profile, an improving domestic market share at liberalised prices and gaining access to LNG export markets would all be positive rating factors.

Liquidity and Debt Structure

Adequate Liquidity: Novatek's liquidity position is adequate for the current ratings. At 30 September 2012, cash on its balance sheet of RUB17.5bn coupled with a last-twelve-months' (LTM12) FFO of RUB80bn was adequate to cover RUB18.9bn of short-term debt.

Maturity Profile: Novatek's debt maturity profile is not onerous, despite maturities of around RUB36bn over the next two years. Fitch expects the company to continue to enjoy ready access to international debt capital markets to further term out these maturities.

Peer Group

Issuer	Country
BBB	
OAO Gazprom	Russian Federation
OJSC OC Rosneft	Russian Federation
BBB-	
Indian Oil Corporation Ltd	India
Kerr-McGee Corp.	United States
MOL Hungarian Oil and Gas Company Plc	Hungary
OAO LUKOIL	Russian Federation
TNK-BP International Ltd.	Russian Federation
BB+	
OAO Tatneft	Russian Federation

Issuer Rating History

Date	LT IDR (FC)	Outlook/Watch
7 Nov 12	BBB-	Stable
30 Oct 12	BBB-	Stable
27 Sep 12	BBB-	Stable
27 Oct 11	BBB-	Stable
10 Nov 10	BBB-	Negative
5 Oct 10	BBB-	Stable
19 Oct 09	BBB-	Stable
9 Oct 09	BBB-	Stable

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Russia’s average daily crude oil production exceeded 10 million barrels in 2011, up 1.2% on 2010. Key challenges facing the industry include sustaining this growth and continuing with the capex programmes necessary to maintain existing reserve and production profiles. Russian oil companies reinstated capex programmes in 2010 in the wake of recovering oil prices. The ability to complete projects scheduled to begin production in 2013 and 2014 remains key to the industry’s prospects.

Financial Risks

The Russian oil and gas sector remained highly capital intensive in 2011, and Fitch expects this to continue throughout 2012. The agency revised upward its base-case Brent oil price deck in August 2012 to USD105/bbl for 2012, USD90/bbl for 2013 and USD82.5/bbl for 2014.

Peer Group Analysis in 2011

	Rosneft BBB/Stable	LUKOIL BBB-/Stable	TNK-BP BBB-/Stable	Novatek BBB-/Stable	Tatneft BB+/Stable
Production (mmbobd)	2.36	2.12	1.77	0.86	0.51
EBITDAX per boe (USD)	25.9	23.4	22.0	9.8	19.0
Adj. debt/reserves (USD)	1.42	0.54	0.93	0.61	0.53
FFO adj. leverage (x)	1.45	0.59	0.87	1.23	1.12

Source: Fitch, companies

Key Credit Characteristics

The creditworthiness of Russian integrated oil companies is supported by their healthy balance sheets and relatively low leverage. The sector experienced a recovery in both revenue and earnings with oil price stability in 2011. If oil prices remain high, 2012-2013 should also prove favourable for the industry.

Overview of Companies

OAO Novatek (‘BBB-/Stable’) – Russia’s second largest natural gas producer (after OAO Gazprom) with production in 2011 of 48 billion cubic metres (bcm), or 53bcm including joint venture operations.

OJSC OC Rosneft (Rosneft, ‘BBB-/RWN’) – Russia’s leading oil and gas producer (excluding OAO Gazprom (‘BBB-/Stable’)). Rosneft’s ratings incorporate state support, resulting in a one-notch uplift to its standalone Long-Term IDRs. Fitch placed the company’s ratings on RWN in October 2012 following the announced acquisition of TNK-BP, but expects the company to remain investment grade.

OAO LUKOIL (LUKOIL, ‘BBB-/Stable’) – Russia’s largest private integrated oil and gas company and the second-largest oil and gas producer (ex-OAO Gazprom), with 2011 oil and gas production of 2.1 million barrels of oil equivalent per day (boepd) and proved reserves of 16.9bn boe.

TNK-BP International Ltd. (TNK-BP, ‘BBB-/Stable’) – Russia’s third-largest oil and gas producer at 1.77 million boepd (excluding equity affiliates and JVs such as Slavneft) in 2011. Fitch placed the company’s ratings on RWN in October 2012 following the announced acquisition of the company by Rosneft.

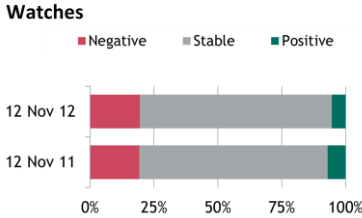
OAO Tatneft (‘BB+/Stable’) – the sole oil producer in the Republic of Tatarstan (‘BBB-/Stable’), with about 510,000bpd. Tatneft’s production is mainly heavy sour crude, and the Russian Federation (‘BBB-/Stable’) is exploring ways to remove it from the country’s Urals Blend exported crude in an attempt to reduce the price differential with Brent.

Related Criteria

Corporate Rating Methodology (August 2012)

Distribution of Sector Outlooks

Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

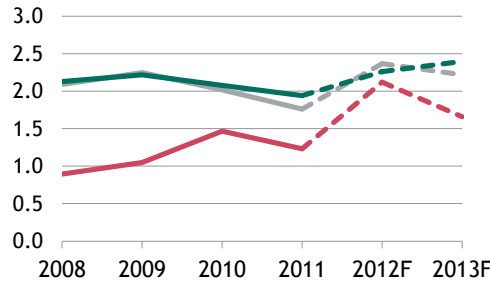
- domestic gas prices increase by 15% p.a. in the medium term, and rising by a CAGR of 30% as announced in September 2012;
- acquisition of a 49% stake in Nortgaz closing in 2012;
- investment requirements rising in line with profitability;
- dividend payout ratio of 30%;
- loans and debt instruments falling due are successfully refinanced.

Definitions

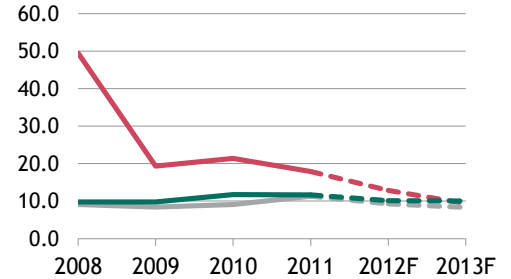
- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- Interest cover: FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.
- FCF/revenue: FCF after dividends divided by revenue.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

OAQ Novatek — Energy (Oil & Gas) Median — Emerging BBB Cat Median
Source: Company data; Fitch.

Leverage including Fitch expectations

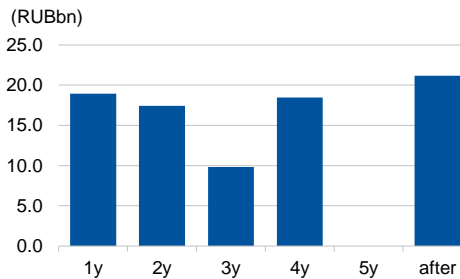


Interest Cover including Fitch expectations



Novatek's Debt Maturity Profile

As at 30 September 2012



Source: Novatek

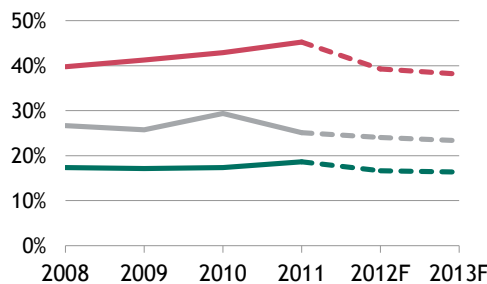
FCF/Revenues including Fitch expectations

including Fitch expectations



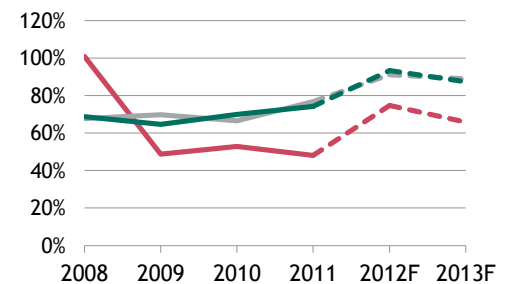
FFO Profitability including Fitch expectations

including Fitch expectations

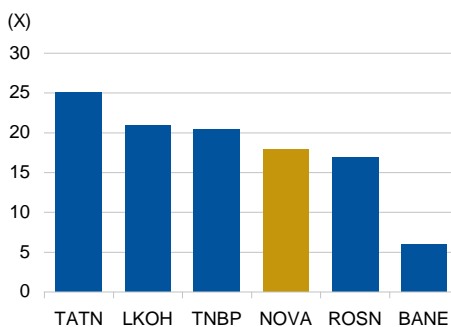


Capex/CFO including Fitch expectations

including Fitch expectations

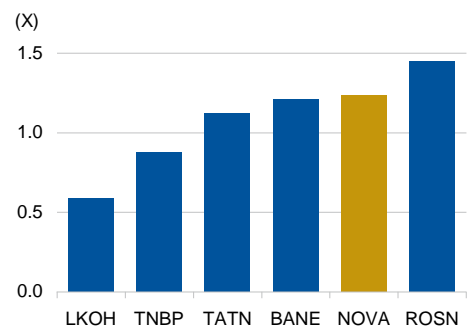


Peer Group: 2011 FFO Fixed Charge Cover



Source: Fitch

Peer Group: 2011 FFO Adj. Leverage



Source: Fitch

**OAO Novatek
FINANCIAL SUMMARY**

	31 Dec 2011 RUBm Original	31 Dec 2010 RUBm Original	31 Dec 2009 RUBm Original	31 Dec 2008 RUBm Original	31 Dec 2007 RUBm Original
Profitability					
Revenue	161,541	109,559	82,762	72,457	56,741
Revenue Growth (%)	47.45	32.38	14.22	27.70	30.15
Operating EBIT	79,442	49,443	33,456	31,973	25,365
Operating EBITDA	88,917	56,200	39,194	36,554	29,099
Operating EBITDA Margin (%)	55.04	51.30	47.36	50.45	51.28
FFO Return on Adjusted Capital (%)	22.95	20.52	21.03	23.90	26.54
Free Cash Flow Margin (%)	16.59	(26.42)	10.95	(10.97)	(7.67)
Coverages (x)					
FFO Gross Interest Coverage	17.89	21.39	19.32	49.54	93.86
Operating EBITDA/Gross Interest Expense	15.18	21.59	18.67	164.66	110.64
FFO Fixed Charge Coverage (inc. Rents)	17.89	21.39	19.32	49.54	93.86
FCF Debt-Service Coverage	1.26	(0.97)	0.70	(1.06)	(0.60)
Cash Flow from Operations/Capital Expenditures	2.08	1.89	2.05	0.99	1.09
Debt Leverage of Cash Flow (x)					
Total Debt with Equity Credit/Operating EBITDA	1.07	1.29	0.96	0.72	0.23
Total Debt Less Unrestricted Cash/Operating EBITDA	0.81	1.10	0.69	0.42	0.09
Debt Leverage Including Rentals (x)					
Annual hire lease rent costs for long-term assets (reported and/or estimate)	0	0	0	0	0
Gross Lease Adjusted Debt/Operating EBITDAR	1.07	1.29	0.96	0.72	0.23
Gross Lease Adjusted Debt /FFO+Int+Rentals	1.23	1.47	1.05	0.89	0.28
FCF/Lease Adjusted Debt (%)	28.07	(40.07)	24.05	(30.25)	(65.90)
Debt Leverage Including Leases and Pension Adjustment (x)					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	1.07	1.28	0.96	0.72	0.23
Liquidity					
(Free Cash Flow+Available Cash+Committed Facils)/(ST Debt + Interest) (%)	223.27	(59.74)	137.49	52.42	(1.75)
Balance Sheet Summary					
Cash and Equivalents (Unrestricted)	23,848	10,238	10,643	10,992	3,982
Restricted Cash and Equivalents	0	0	0	0	0
Short-Term Debt	20,298	25,152	13,827	6,342	6,560
Long-Term Senior Debt	75,180	47,074	23,876	19,935	42
Subordinated debt	0	0	0	0	0
Equity Credit	0	0	0	0	0
Total Debt with Equity Credit	95,478	72,226	37,703	26,277	6,602
Off-Balance-Sheet Debt	0	0	0	0	0
Lease-Adjusted Debt	95,478	72,226	37,703	26,277	6,602
Fitch- identified Pension Deficit	0	0	0	0	0
Pension Adjusted Debt	95,478	72,226	37,703	26,277	6,602
Cash Flow Summary					
Operating EBITDA	88,917	56,200	39,194	36,554	29,099
Gross Cash Interest Expense	(4,326)	(2,303)	(1,863)	(593)	(250)
Cash Tax	(13,933)	(8,575)	(4,264)	(8,791)	(6,099)
Associate Dividends	0	0	0	0	0
Other Items before FFO (incl. interest receivable)	2,400	1,632	1,067	1,616	464
Funds from Operations	73,058	46,954	34,134	28,786	23,214
Change in Working Capital	(4,548)	(4,210)	(855)	2,515	(1,699)
Cash Flow from Operations	68,510	42,744	33,279	31,301	21,515
Total Non-Operating/Non-Recurring Cash Flow	6,437	(39,183)	(347)	(3)	(340)
Capital Expenditures	(32,978)	(22,636)	(16,238)	(31,596)	(19,666)
Dividends Paid	(15,166)	(9,868)	(7,628)	(7,652)	(5,860)
Free Cash Flow	26,803	(28,943)	9,066	(7,950)	(4,351)
Net (Acquisitions)/Divestitures	(17,523)	(5,205)	(18,615)	(193)	(984)
Net Equity Proceeds/(Buyback)	354	678	1,767	(599)	0
Other Cash Flow Items	(22,673)	(3,577)	(5,561)	(4,136)	287
Total Change in Net Debt	(13,039)	(37,047)	(13,343)	(12,878)	(5,048)
Working Capital					
Accounts Receivable Days	25	22	18	12	15
Inventory Days	12	15	20	28	33
Accounts Payable Days	24	19	45	70	50

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