Energy (Oil & Gas)
Russian Federation
Credit Analysis

OAO Novatek

Ratings

Security Class	Current Ratings
Foreign Currency	
Long-Term IDR	BBB-
Local Currency	
Long-Term IDR	BBB-

Outlooks

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

Financial Data

OAO Novatek

	Dec 31 2008	Dec 31 2007
Revenue (RUBm)	72,457	56,741
Operating EBITDAR (RUBm)	36,554	29,099
Op. EBITDAR/revenues (%)	50.4	51.3
Op. EBITDAR/fixed charges (x)	164.7	110.6
Cash flow from operations (RUBm)	31,301	21,515
Free cash flow (RUBm)	-7,950	-4,351
FFO/interest expense net of interest income (x)	-154.6	-204.4
Total debt (RUBm)	26,277	6,602
Closing net debt (RUBm)	15,285	2,620
Total adjusted debt/ op. EBITDAR (x)	0.7	0.2
Total adjusted (recourse) debt/op. EBITDAR (x)	0.7	0.2
Adjusted leverage/FFO (x)	0.9	0.3

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Related Research

- *Oil and Gas Sector Exploration and Production Rating Methodology (October 2008)*

Rating Rationale

- OAO Novatek's (Novatek) rating is supported by a strong business profile stemming from a high production growth rate and its unique role as a key incremental gas producer in relation to Russia's national energy balance, allowing OAO Gazprom ('BBB'/'F3'/Negative) to meet export commitments and reducing the country's dependence on increasingly expensive imported gas from Central Asia.
- Novatek continues to benefit from the government's plan to liberalise the price of natural gas sold on the Russian domestic market by 2011. Gas prices are expected to increase by 15%-26% in 2010. The company is also a low-cost producer of natural gas, which contributes to its high profit margins.
- Novatek has positioned itself to participate in the next phase of Russia's natural gas development by purchasing 51% of Yamal LNG in May 2009. Prime Minister Putin has expressed a desire to see this area developed; and the company hopes to do this in co-operation with its minority shareholder, Gazprom.
- Novatek's credit profile is challenged by its relatively small scale and lack of integration. The company is expected to face high capital expenditure commitments to develop Yamal LNG, which could put prolonged pressure on the company's leverage ratios and free cash flow metrics.

Key Rating Drivers

- Achieving a development strategy for Yamal LNG with Gazprom would be positive for the rating.
- Reducing or reversing vulnerability to contract price negotiations that resulted in a material increase in non-controllable expenses in Q209 would also be positive for the rating.
- The rating would benefit from: lessening customer concentration in total revenue; successful lengthening of the short-term debt maturity schedule; and a return to positive free cash flow generation by 2010-2011.

Recent Events

In September 2009, Prime Minister Vladimir Putin invited executives from Exxon Mobil Corp. ('AAA'/'F1+'/Stable), Royal Dutch Shell ('AA+'/'F1+'/Stable), ConocoPhillips ('A'/'F1'/Stable) and Total SA ('AA'/'F1+'/Stable) among others to discuss developing natural gas resources on the Yamal Peninsula. This followed Novatek's acquisition of a 51% stake in Yamal LNG in May 2009. The involvement of foreign companies would be positive for Novatek as it would provide both technological expertise and international exposure to potential new export markets.

Liquidity and Debt Structure

At end-June 2009, Novatek had approximately USD250m of cash on balance sheet deposited with highly-rated international banks. The company also had available short-term credit facilities totalling USD400m, of which USD350m was undrawn. This compares with short-term debt obligations of USD687m. Leverage remains low, with LTM09 to June 2009 net debt to EBITDA of 1.0x. Other leverage metrics, such as net debt to total capitalisation, also remain low relative to peers. For example, in June 2009, Novatek's net debt to total capitalisation ratio was 22%, well below that of other major European international oil companies whose target ratios tend to be 20%-30% and can at times reach 40%.

Business Description

In Russia, Novatek is the largest independent natural gas producer, and the second-largest producer of natural gas overall after Gazprom. In 2008 it had annual production capacity of 36.5 billion cubic meters (bcm). The company has plans to increase annual production capacity to 45bcm by 2010 and to 65bcm by 2015. Novatek has been producing gas since 1998 and currently produces primarily from its three core gas fields in the Yamal-Nenets autonomous region located in Western Siberia, and supplies 5% of Russia's total natural gas output and approximately 8% of domestic demand. Novatek also owns and operates the Purovsky processing plant, located in close proximity to its core fields. This plant produces gas condensate and liquid petroleum gas (LPG) for domestic and international markets.

Corporate Governance and Management

Corporate Governance

Like many other companies operating in the Russian Federation, Novatek has developed its own internal corporate governance code, which is available on its website. The company is also required to comply with the corporate governance regulations of the Russian Federation and the UK Financial Reporting Council's Combined Code on Corporate Governance as part of the stock exchange listing requirements in Russia and the UK.

In 2008, Novatek increased the size of its board of directors from eight to nine members. Fitch regards this as a positive development, as an odd number of members will enhance the board's decision-making ability. Gazprom, which owns 19.4% of Novatek, has two board seats. The board also has four independent directors, according to the definition contained in the combined code of the Russian Federation, which is a large number in Russia. Novatek also publishes the board members' attendance record at the three internal committees it established in 2005. Fitch regards the fact that the positions of chairman and CEO are held by different individuals as a positive corporate governance factor.

Novatek reports financial figures quarterly and prepares a management discussion and analysis report. Its oil and gas reserves are estimated in accordance with rules established by the US SEC for proved reserves and are reviewed annually by the company's independent petroleum reservoir engineers, DeGolyer and MacNaughton. Unlike other oil companies operating in Russia, Novatek discloses separate information on proved oil and gas reserve quantities for periods up to and past the license expiry dates. This additional disclosure goes beyond that made by other oil and gas companies operating in the Russian Federation, and is considered by Fitch to be a positive factor in terms of corporate governance transparency.

Quality of Management

Novatek's management is comprised mainly of local individuals who possess a wide range of experience and expertise in strategic and commercial oil and gas activities. Novatek has been operating in the Russian gas market for 10 years, and can essentially trace its origins to the acquisition of a few undeveloped exploration licenses in western Siberia.

Novatek is the largest independent natural gas producer in Russia, having achieved this through strategically investing capital to expand its resource base and production. As demonstrated by the company's historical financial metrics, growth has been managed effectively, and production increases have largely been achieved organically, rather than through leveraged acquisitions. Although the company increased borrowing in 2009 to finance the Yamal LNG acquisition, Fitch expects management to continue to employ the same conservative management practices over the medium to long term that have contributed to the company's successful development to date.

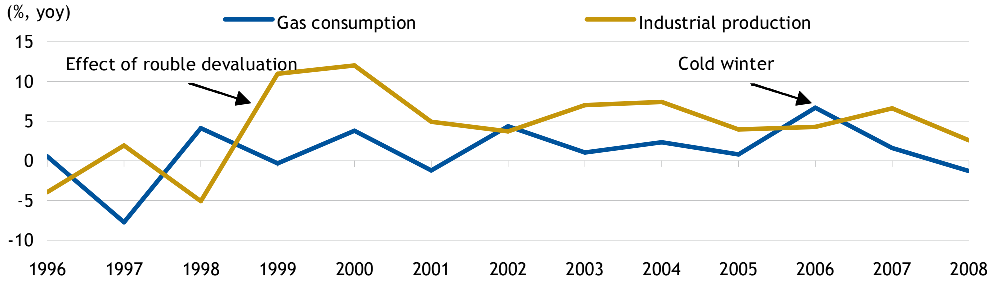
Business Profile

Industry Conditions

Due to its large industrial base and cold winter climate, Russia is the second largest global consumer of natural gas after the US. In 2008, Russia used approximately 420bcm of natural gas, about 14% of total global consumption, according to the BP Statistical Review of Global Energy for that year. Natural gas accounts for more than 50% of the primary energy supply and in some regions for 80%.

Demand for natural gas in Russia rose steadily by about 1.7% annually during 1998-2008 partially due to industrial economic growth and partially to a greater reliance on natural gas to produce electricity and heat. As *Chart 1* shows, the correlation between domestic gas consumption and economic growth (as measured by industrial production) is quite low. Demand for natural gas in the Russian domestic market is to some extent influenced by demand from manufacturing segments like chemicals and steel, but is mainly driven by other factors such as demand from electricity, municipal, residential and other consumers, which collectively account for more than 50% of gas consumption in Russia.

Chart 1: Russian Domestic Gas Consumption vs. Industrial Production
As of December 2008



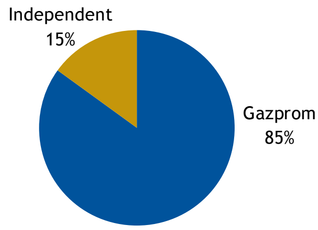
Source: BP statistical review, IIF

Despite the current economic crisis in Russia, which in part caused aggregate natural gas consumption to decrease by 1.3% in 2008, Novatek increased gas production by 7.7% in the same period and reported an increase in production of 4.9%, in H109. The resilience of the company's production is partly due to the steady demand for gas to produce electricity in markets served by Novatek and partly due to the company's production slate flexibility, which allows the company to change between gas and liquids production.

The country's domestic natural gas industry is dominated by Gazprom, which supplies approximately 85% of Russian gas consumption (see *Chart 2*). The other 15% of consumption is supplied by independent producers such as Novatek and other integrated oil and gas companies.

The role of independent gas producers in the Russian gas balance has steadily grown in importance since 1999, as these companies increasingly play an important role as incremental gas suppliers that bridge the gap between domestic supply and demand. This "call on independents" is important to the energy strategy of the Russian Federation for three reasons. First, independent producers supplying the domestic market lessen the burden on Gazprom to meet domestic supplies and

Chart 2: Russian Domestic Market
December 2008



Source: Fitch

allow the company to fulfil its contractual export commitments to Europe. Second, production from independent producers reduces the need to import gas from Central Asia, which Fitch expects to become more expensive as governments in the region have expressed a desire to achieve a higher price for this commodity. Third, independent producers participate in regional gasification programmes, which are a key component of the government's 2030 energy strategy.

Price Deregulation

As part of its commitments on joining the World Trade Organization (WTO), in 2006 Russia implemented a strategy to liberalise domestic gas prices by 2011 with the aim of reducing the perceived competitive advantage that lower energy costs have on Russian industry's cost of production. As a result, the Russian government has authorised a series of regulated price increases for natural gas (approximately 25% per year over the period) in order to achieve netback parity to gas prices in western European markets. Despite the financial and economic crisis affecting the global and Russian economies, the government has continued to implement its price liberalisation plan by raising regulated domestic gas prices by 25% in 2008 and 15.9% in 2009, and has approved additional price increases of 15%-26% in 2010.

Because Novatek is an independent gas producer in Russia, it is not directly subject to the government's regulation of natural gas prices. It is, however, strongly influenced by government-regulated prices and international and domestic market conditions. As a result, Novatek's average natural gas netback prices are broadly in line with the regulated prices set by the government for Gazprom's domestic gas sales. The material increases in domestic natural gas prices as part of the government's price liberalisation plan have resulted in significant financial benefits to Novatek. The company expects fully liberalised prices after 2011 to allow it to increase production capacity and provide financial incentives to further expand investment into exploration and development initiatives.

Competitive Position

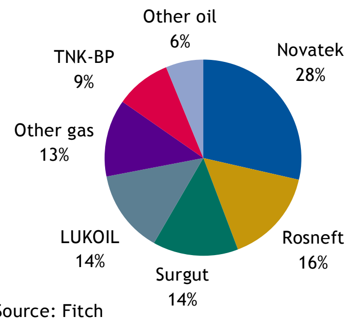
Although Novatek's share of the total Russian gas market is relatively small (it supplies 5% of Russia's total natural gas output and approximately 8% of domestic demand) it has the largest market share among independent producers, 28% of Russian independent gas production (see *Chart 3* below). More importantly, the company occupies a unique position in the domestic gas market as a key incremental producer, which gives it considerable competitive advantages such as an ability to penetrate new regional markets and enter new long-term supply agreements with end customers.

Novatek believes international and domestic demand for natural gas will remain positive despite recent cyclical weakness caused by the global economic crisis, and that the supply gap in the Russian domestic market (currently around 100bcm per year) will remain, allowing the company to increase market share.

The company also considers itself to have two other competitive advantages relative to peers. The first advantage is the strategic location of its core gas fields in a hydrocarbon-rich basin in northern Russia with proximity to transportation infrastructure; the second advantage is a greater degree of operational and production flexibility in switching between producing natural gas from the shallower dry gas layers to the deeper wet gas layers in order to increase gas condensate production and sales of stable gas condensate and liquid petroleum gas (LPG).

Chart 3: Novatek Market Share

December 2008



Source: Fitch

Novatek's three core fields are located in the world's largest natural gas production region in an area with large proved reserves, allowing the company to achieve low-cost production and stable reserve replacement. Additionally, the company's fields are in close proximity to existing trunk gas pipeline infrastructure, which negates the need to expend large amounts of capital expenditure on infrastructure build-out projects.

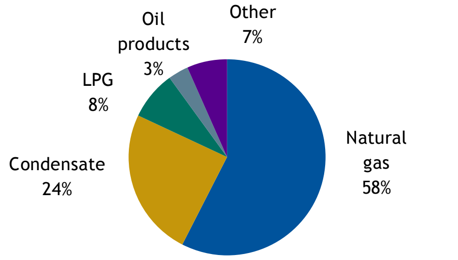
The company also has exposure to export markets through sales of gas condensate and LPG. With the Russian government having eliminated export duties for LPG in 2009, Novatek decided to optimise its revenue by increasing condensate and LPG production. In H109, natural gas production increased by 4.9%, while production of condensate and LPG increased by 27.5% and 11.7%, respectively, compared with the same period in 2008. Novatek views its ability to move quickly between these markets as a key competitive advantage over other independent gas producers in Russia.

Novatek's Product Offering and Customer Base

Although Novatek is mainly a dry natural gas producer, representing about 58% of revenue, as shown in *Chart 4*, the company has additional product offerings such as stable gas condensate, representing 24% of revenue, and LPG, representing 8% of revenue, that it produces at its Purovsky plant and then exports to Europe, the US and from 2009 to South Korea. Export volumes of stable gas condensate are shipped via the all-season port of Vitino on the White Sea, where Novatek has storage and transhipment facilities. In conjunction with the completion of the second phase of development of the company's second-largest field by production, the company started its second-phase expansion of the Purovsky plant in November 2008. The commissioning of the second-phase development has more than doubled the plant's processing capacity to 5.0 million tonnes per year (mmtpy) from 2.0mmtpy.

Chart 4: Novatek Revenues by Product

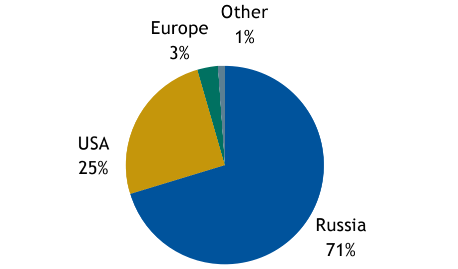
December 2008



Source: Novatek, Fitch

Chart 5: Novatek Revenues by Location

December 2008



Source: Novatek, Fitch

As Chart 5 shows, Novatek operates in three major geographical areas of the world. In Russia, the company generates slightly more than 70% of its total revenue and is involved in the exploration, development, extraction and sale of natural gas, gas condensate and related products. In the US, the company generates about 25% of its revenue through the sale of stable gas condensate, while in Europe, representing just 3% of revenue, sales are a combination of gas condensate, LPG and to a lesser extent crude oil.

Fitch considers the company's relatively high customer concentration to be an area of vulnerability in its revenue base. At end-June 2009, sales to two major customers accounted for nearly 30% of total revenue (more than 10% each). By contrast, in 2008 there were no customers that accounted for more than 10% of revenue.

Recent Strategic Transactions

In May 2009 Novatek acquired 51% of OAO Yamal LNG for USD550m. An additional USD100m will fall due from Novatek to the seller by end-2011 upon the conclusion of an agreement between Yamal LNG and Gazprom defining the main terms of the sale of liquefied natural gas (LNG) produced from the South-Tambeyskoye field. This agreement must be concluded no later than December 2011, otherwise the amount will not fall due. In August 2009 Gazprom and Novatek held a working meeting to discuss the formation of a general plan for the development of hydrocarbon resources in the Yamal Peninsula. The two sides discussed the development plan for Novatek's newly acquired subsidiary as part of a general plan to create LNG production capacity on the Yamal Peninsula.

Yamal LNG is an exploration-stage oil and gas company located in the north-east part of the Yamal Peninsula. The company holds the license (expiring in 2020) for exploration and development of the South-Tambeyskoe field, which has been identified by the Russian government as a strategic field and is envisaged as part of a strategy to produce LNG for export from the peninsula. In the meantime, the acquisition of the field significantly increases Novatek's resource base. Novatek estimates that the field holds approximately 320bcm of proved plus probable reserves. Management plans to include the South-Tambeyskoe field in its 2009 year-end reserve report once it has been appraised by its independent petroleum reservoir engineers, DeGolyer and MacNaughton.

At the same time as the purchase of the stake in Yamal LNG, Novatek acquired a three-year call option to purchase an additional 23.9% in the company for USD450m. It is possible this additional stake could be sold to a strategic partner in order to obtain the technical expertise required to develop LNG production facilities at Yamal.

An LNG production strategy for Yamal appears to be part of a wider government-backed plan that forms part of the country's overall energy strategy. In September 2009 Prime Minister Putin invited executives from Exxon Mobil Corp. ('AAA'/'F1+'/Stable), Royal Dutch Shell ('AA+'/'F1+'/Stable), ConocoPhillips ('A'/'F1'/Stable) and Total SA ('AA'/'F1+'/Stable) among others to discuss developing natural-gas resources on the Yamal Peninsula. The involvement of foreign companies in developing the region would be positive for Novatek, as it would provide both technological expertise and international exposure to potential new export markets. Furthermore, Novatek is already cooperating with Total SA, and signed a separate joint venture agreement in June 2009 to develop the Termokarstovoye gas and gas condensate field with a final investment decision expected in 2011. According to Total SA, the field could produce more than 47.3bcm of gas and about 10.3 million tons of condensate.

Upstream Operations

Reserve Position

Novatek's reserves are expected to increase materially as a result of the acquisition of Yamal LNG in May 2009. At end-2008, Novatek held approximately 4.5 billion barrels of oil equivalent (boe). Although final appraisal of the South-Tambeyskoe field will be necessary to determine the amount of estimated proved reserves, Fitch considers that this could be as much as 1.0 billion boe, which would bring the company's proved reserves in line with those of Tatneft ('BB'/'B'/Stable).

Table 1: Reserve Position End-2008

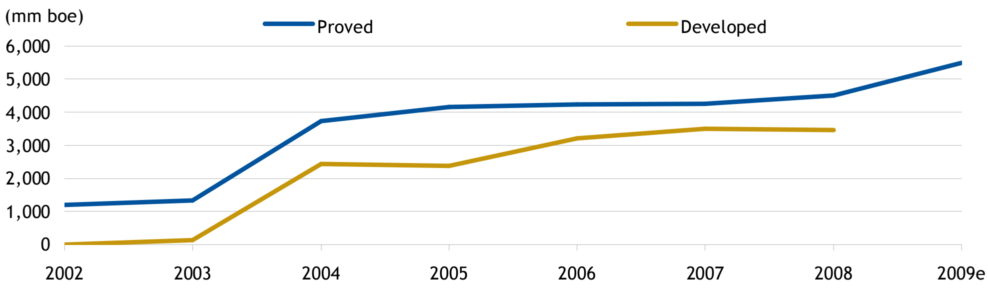
(m boe)	Rosneft	LUKOIL	TNK-BP	Tatneft	Novatek
Proved reserves	13,360	19,089	8,090	5,625	4,512
Developed reserves	10,032	10,315	5,156	5,467	3,457
Developed (%)	75.1	54.0	63.7	97.2	76.6

LUKOIL based on PRMS, others based on SEC-LOF
Source: Company financials, Fitch

Fitch expects the proportion of Novatek's developed reserves to decline from approximately 76.6% at end-2008 to closer to 65% once proved reserves have been booked. Fitch considers a proportion of 60%-80% to be an optimal level, as it signifies a balanced portfolio of assets more capable of enabling a company to generate ongoing cash flow. A ratio of developed reserves below 60% could indicate large future capex demands and long project lead times.

Chart 6 below shows the history of the company's reserve position. There was a material increase in the company's developed reserves in 2004, which was followed by a material increase in production in the following year. The company has a respectable track record of reserve development since 2004, and Fitch expects this to continue with respect to development of Yamal LNG, primarily due to the positive discussions taking place with the company's minority stakeholder, Gazprom. Gazprom's continued cooperation is viewed by Fitch as very important to the development strategy for Yamal LNG. Should this participation become less evident, it would be likely to have negative rating consequences for Novatek.

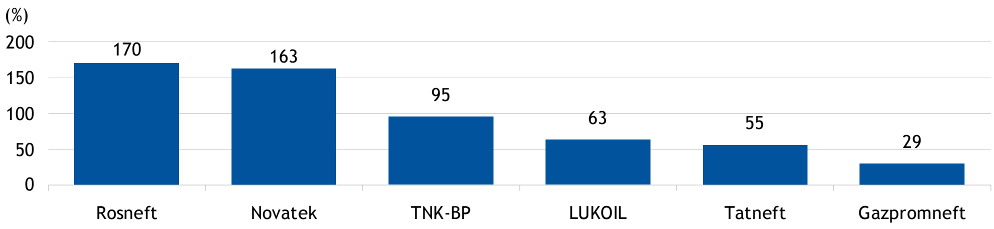
Chart 6: Total Proved Reserves (SEC)
As of December 2008



Source: Company filings, Fitch

Novatek's main producing fields are located in the resource-rich basin of the Yamal-Nenets autonomous region. The company has therefore had considerable success in replacing its reserves at exceptionally low costs. As *Chart 7* shows, Novatek has the second-highest basic replacement ratio in Russia after Rosneft ('BBB-'/Negative) by three-year average. Although the basic replacement ratio includes reserves replaced through acquisitions, Novatek has achieved this replacement ratio entirely through organic finding and development. Fitch regards this as positive for the company's continued future development potential.

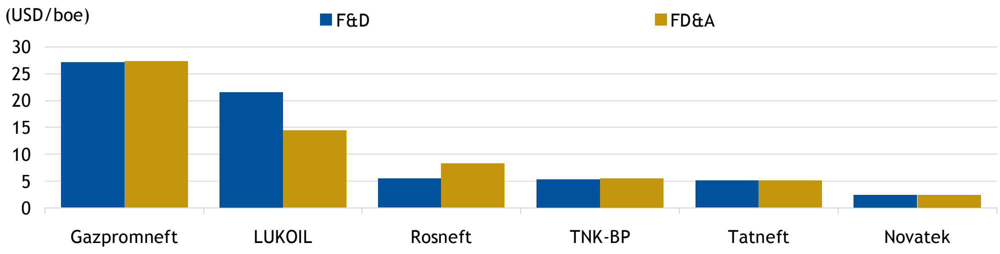
Chart 7: Basic Replacement Ratio
As of December 2008



LUKOIL based on PRMS
Source: Company financials, Fitch

Novatek has the lowest finding and development cost structure of all the major Russian oil and gas companies (see *Chart 8* below). It is able to achieve this through a combination of factors such as working with relatively shallow deposits located at depths of 2,300-4,300 metres and employing advanced drilling techniques. As a result, the company's three-year average finding and development cost per barrel of equivalent oil is approximately USD2.40, less than the average for all the other companies.

Chart 8: Upstream Finding & Development Costs (3-Year Average)
As of December 2008



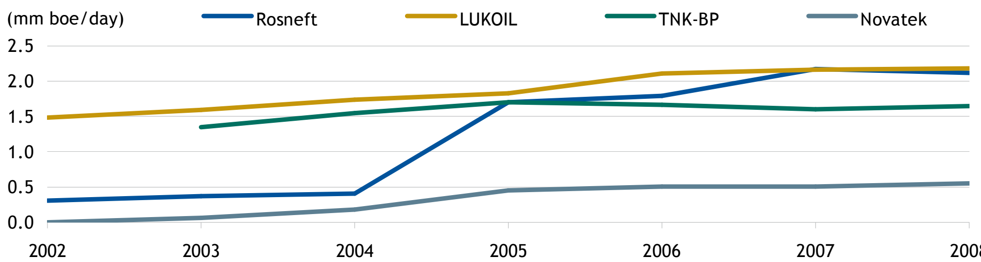
LUKOIL based on PRMS
Source: Company financials, Fitch

Novatek is also exploring possibilities for diversifying its reserve base beyond Russia. In 2008 the company continued work at its international exploration project, the El-Arish offshore block in Egypt. Novatek invested RUB346m in running and interpreting 3D seismic data in 2008. As a result of this analysis, the company will continue exploration work at its prospective fields and license areas and plans to begin exploration drilling in 2010.

Production Profile

As *Chart 9* below shows, Novatek's production of approximately 500,000 boe per day remains considerably lower than that of other similarly rated peers operating in Russia, which have production in excess of 1.5 million boe per day. Nevertheless, the company occupies a unique position in the country's energy markets and is expected to benefit from future developmental cooperation with its minority shareholder Gazprom to develop important production projects. Fitch considers that this could eventually bring production closer to 1 million boe per day by 2015. The government's plans to liberalise prices by 2011 also provide new incentives for the company to maximise revenue by increasing both current production and future production capacity.

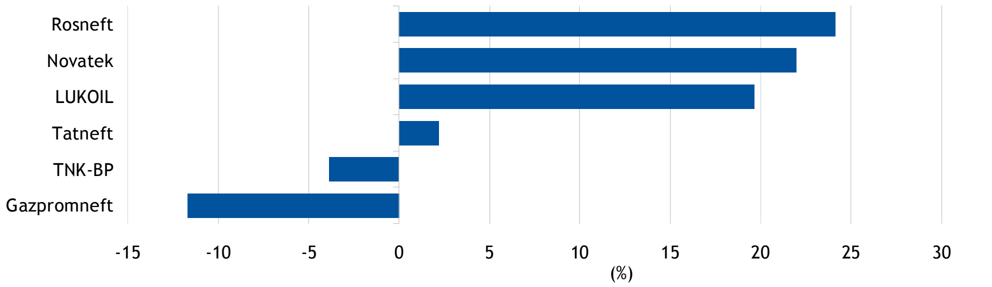
Chart 9: Total Hydrocarbon Production
As of December 2008



Source: Company filings, Fitch

Novatek has achieved an impressive three-year average increase in production, largely due to successful completion of key development projects such as the second phase of the Yurkharovoskoye field in 2008. As *Chart 10* below demonstrates, the company achieved a cumulative increase in output of more than 20% over three years, in line with larger Russian operators such as Rosneft and Lukoil ('BBB-'/'F3'/Stable).

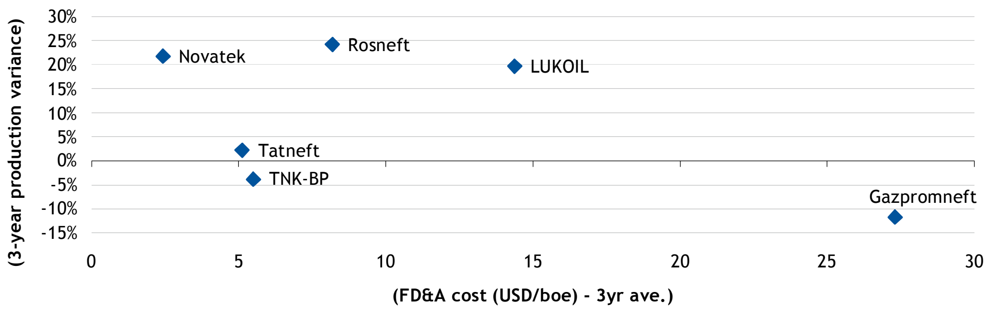
Chart 10: Three Year Cumulative Change In Production
As of December 2008



Source: Company financials, Fitch

The combination of high production growth rates and low cost reserve replacement places Novatek in a more favourable position than peers as measured by capital efficiency. As *Chart 11* below shows, Novatek is the leader among its peers in terms of demonstrating ability to increase production and simultaneously replace depleted reserves at low cost.

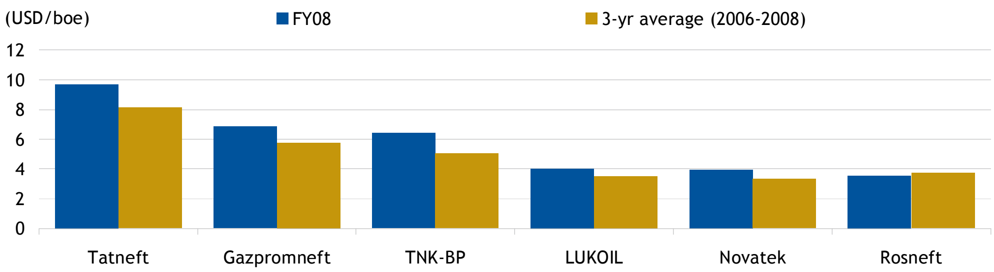
Chart 11: Capital Efficiency



Source: Fitch

Novatek has also displayed an ability to effectively control upstream production costs, and remains a low-cost producer among peers (see *Chart 12*). The company is able to achieve this due to the location of its main production facilities in the hydrocarbon-rich basin of Yamal with close proximity to trunk line transport infrastructure. Fitch measures production costs as lifting costs plus transportation expenses. Novatek's lifting costs are low due to the fact that gas extraction is cheaper than oil extraction in general. Additionally, relatively easy access to the Unified Gas Supply System controlled by Gazprom makes it easier and less capital intensive to connect to the pipeline network, once again giving the company a competitive advantage relative to peers.

Chart 12: Upstream Production Costs
As of December 2008



Source: Company financials, Fitch

Financial Profile

Financial Policy

Novatek's financial policy is moderately conservative. Relative to similarly sized peers operating in the same line of business outside Russia, such as Pioneer Natural Resource Co. ('BB+'/Stable) and Pride International Inc. ('BB+'/Stable), Novatek has more conservative credit metrics and does not tend to use large amounts of debt to finance operations. The company has also developed conservative internal financial management policies such as maintaining liquidity of USD100m-150m and a debt/EBITDA ratio of around 1.0x over its three- to five-year business cycle.

The recent partially debt-financed acquisition of Yamal LNG using short-term debt could be viewed as a deviation from previous policy; however, Novatek announced plans in September 2009 to refinance this debt with the issuance of rouble bonds with a three-year maturity (see "Capital Structure" and "Financial Flexibility" below). Additionally, in August 2009 the company's board of directors approved a plan to repay approximately RUB2.8bn of debt payable to Gazprombank, which was raised as part of the Yamal LNG transaction, ahead of maturity.

Profitability and Earnings

Novatek has managed to achieve high profit margins, partly due to the government's natural gas price liberalisation plan, which has resulted in yoy price increases and partly to the company's legacy low production costs. This combination has allowed Novatek to achieve EBITDAR margins in excess of 50%, comparable only to those of Rosneft over several years.

Novatek's profit margins have deteriorated since 2005, in line with those of other peers (see Table 2), mainly due to factors such as rising selling, distribution and administrative expenses, and increasing expenditure for purchases of oil, gas condensate and natural gas. Gross profit margins, which only include expenses such as transportation expenses, materials and services, depreciation and exploration expenses, remained broadly stable in 2008 at 64.8% compared with an average of 66.8% since 2004.

Table 2: EBITDAR Margin

(%)	Rosneft	LUKOIL	TNK-BP	Tatneft	Novatek
2008	52.0	23.2	39.3	19.3	50.4
2007	54.5	26.6	42.9	31.6	51.3
2006	48.1	26.0	41.6	28.4	52.5
2005	56.4	26.6	43.3	28.1	60.4

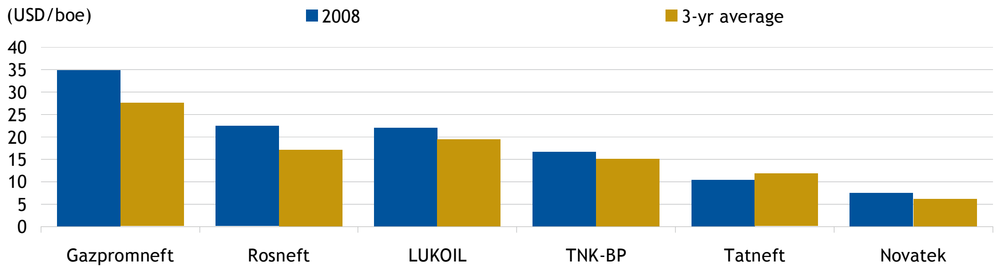
Source: Fitch

In line with price liberalisation, which has resulted in an increase in domestic natural gas prices in Russia, the government has also been increasing the transportation tariffs for natural gas. In 2009, for example, the increase in transport tariffs approved by the Federal Tariffs Service was 15.7%. This has had minimal effect on Novatek's profitability, however, as the increase in regulated transport tariffs are passed on to its end customers under delivery terms in the majority of its contracts. Likewise, other Novatek customers, such as wholesale gas traders, are responsible for the payment of gas transportation tariffs themselves.

Fitch considers that profit margins are likely to come under pressure in 2009, however, as the company faces a change in terms and conditions affecting its ability to pass on transportation expenses. Specifically, in April 2009 the company renegotiated the sales terms for natural gas volumes sold to one of its largest traders. The new terms led to a decrease in Novatek's total average natural gas netback price of 8.6%, mainly due to additional transportation expenses incurred. The increase in transportation expenses incurred by Novatek has also resulted in a 16% increase in the company's "non-controllable expenses" (defined as transportation expenses plus taxes) to 44.2% of total revenue at end-June 2009 from 28.2% in the same period in 2008. Due to these rising operating expenses, Fitch considers that Novatek's EBITDAR margin is likely to fall below 50% in 2009 and also experience a sharper deterioration than that of peers.

Additionally, as *Chart 13* below shows, Novatek's profitability as measured by EBITDAX (X is exploration expenses) to barrels of oil equivalent production tends to lag behind that of peers by a considerable margin. This is mainly due to the fact that Novatek is a pure upstream company, generating all its earnings from exploration and production, whereas the peers listed in *Chart 13* tend to be integrated companies that also generate earnings from downstream refining operations.

Chart 13: EBITDAX to Production (BOE)
As of December 2008



Source: Company financials, Fitch

Cash Flow Protection

Cash flow generation, as measured by funds from operations (FFO), has broadly followed the trend in earnings, rising by an average 56% per year since 2004 (although a large percentage of this was achieved in 2004-2005 and has been more subdued since). In addition to the high rate of growth, the company's cash conversion, as measured by the percentage of FFO converted from EBITDA, has continued to improve and was 78.7% in 2008, up from a low of 53.6% in 2004. A similar trend is observable in the company's average receivables collection period, which decreased to 12 days in 2008 from a high of 26 days in 2004.

Other measures of cash protection, such as FFO net interest coverage, shown in Table 3 below, remain strong relative to similarly rated peers, with Novatek generating net interest income in 2007 and 2008.

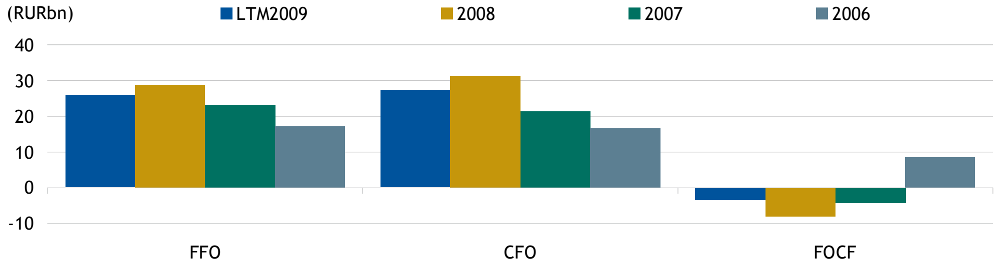
Table 3: FFO Net Interest Coverage

(x)	Rosneft	LUKOIL	TNK-BP	Tatneft	Novatek
2008	13.6	51.9	11.7	n/m	n/m
2007	15.0	65.2	15.2	n/m	n/m
2006	6.4	50.2	42.0	n/m	71.9
2005	7.0	43.7	28.3	480.7	29.2

Years marked 'n/m' indicate interest income exceeds interest expense
Source: Fitch

Despite the effects of the global economic slowdown on Russia, Novatek's cash generation in H109 remained relatively strong. As *Chart 14* below shows, both FFO and cash flow from operations (CFO) in LTM09 have remained close to 2008 levels and are still well above 2007 levels. This is largely due to a combination of price and volume increases over time. CFO in the LTM09 deteriorated somewhat compared with 2008 due to a negative change in working capital that resulted from a decrease in trade payables in H109.

Chart 14: Cash Flow Generation
As of June 2009



Source: Novatek, Fitch

The resulting improvement of free cash flow in the LTM09 compared with 2008 is mainly due to a reduction in capital expenditure of 23.2%. Although the company has postponed some exploration and development activities and delayed commitments to some processing facilities, the reduction in capital expenditure in 2009 is mainly due to the completion of the second stage of development of the Yurkharovoskoye field and the Purovsky plant. Management maintains that it has not made any major adjustments to the long-term capital expenditure programme that would negatively affect the company's development.

As shown in *Table 4*, Novatek's ability to fund capital expenditure from internally generated cash flow remains adequate (around 1.0x) despite having deteriorated in both 2007 and 2008 due to increased expenditure to fund key development projects such as phase two of the Yurkharovoskoye field and the Purovsky plant. This ratio should improve somewhat in 2009, as the reduction in capital expenditure in LTM09 has been greater than the reduction in cash generated from operations.

Table 4: CFO to Capital Expenditure Coverage

(x)	Rosneft	LUKOIL	TNK-BP	Tatneft	Novatek
2008	1.6	1.4	2.2	0.8	1.0
2007	2.7	1.2	2.0	1.4	1.1
2006	0.6	1.2	1.2	1.9	3.5
2005	1.4	1.5	1.6	2.1	2.1

Source: Fitch

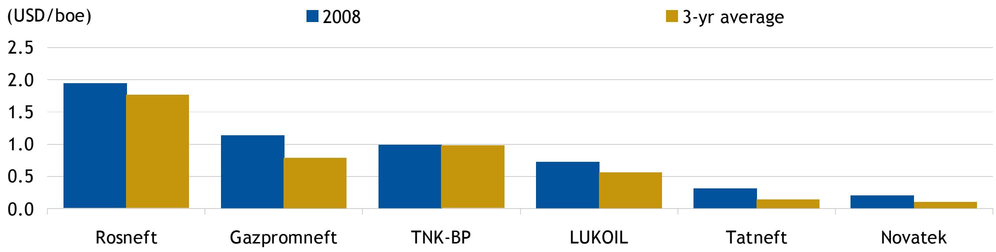
Capital Structure

To finance the acquisition of the 51% stake in Yamal LNG, in June 2009 Novatek issued Russian rouble-denominated promissory notes maturing in February 2010 and totalling RUB8.9bn. The issuance of this short-term debt resulted in an increase in the company's ratio of current debt to total debt to 56.6% in June 2009 from 24.1% in 2008, but is still much lower than the company's average short-term debt ratio of greater than 90% during 2005-2007. In September 2009, the company's board of directors approved a plan to issue Russian rouble bonds. According to the issuing documents, the total maximum nominal value of the bond offering is RUB30bn (approximately USD1bn) and will be divided into four series, each of which will have a three-year maturity.

The remainder of the company's debt capital structure is dominated by a three-year unsecured syndicated term loan facility totalling USD800m, which was obtained in April 2008. At end-June 2009, RUB24,877m (USD795m) had been drawn down under this facility agreement.

As shown in *Chart 15* below, Novatek remains one of the least leveraged oil and gas companies, as measured by total debt to proved reserves, not only in Russia, but internationally. The company's low indebtedness relative to its available resource base provides a greater degree of credit protection relative to peers. This is because a smaller portion of the cash generated from selling an equivalent barrel of oil would be needed to service future debt obligations. Even with increased borrowing to fund the Yamal LNG acquisition, Fitch expects Novatek to maintain its dominant position in relation to this particular credit metric relative to peers for the foreseeable future.

Chart 15: Total Adjusted Debt to Proved Reserves
As of December 2008



LUKOIL based on PRMS
Source: Company financials, Fitch

Other leverage metrics, such as net debt to total capitalisation, remain low relative to peers. For example, at end-June 2009, Novatek's net debt to total capitalisation ratio was 22%, well below that of other major European international oil companies, whose target ratios tend to be 20%-30% and can rise to as much as 40%.

Financial Flexibility

Novatek's liquidity and financial flexibility are supported by management's policy of maintaining cash balances of USD100m–150m and available credit facilities of approximately USD400m. At end-June 2009, the company had approximately USD250m of cash on balance sheet deposited with highly rated international banks. At the same date, the company also had short-term credit facilities totalling USD400m available for use, of which USD350m was undrawn. Of the USD400m short-term credit facilities, USD100m is an unsecured uncommitted credit facility with CALYON maturing in July 2010, USD100m is an unsecured uncommitted credit facility with UniCredit Bank maturing in February 2010, and the remaining USD200m is in the form of unsecured, uncommitted bank overdraft facilities.

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	31 Dec 2008 RUBm Original	31 Dec 2007 RUBm Original	31 Dec 2006 RUBm Original	31 Dec 2005 RUBm Original	31 Dec 2004 RUBm Original
Summary Balance Sheet					
ASSETS					
Cash and Marketable Securities	10,992.0	3,982.0	5,668.0	2,956.0	3,003.0
Accounts Receivable/Trade Debtors	1,819.0	2,950.0	1,869.0	2,311.0	1,716.0
Inventory	2,156.0	1,794.0	1,815.0	1,418.0	929.0
Other Current Assets	9,597.0	7,977.0	5,195.0	4,505.0	3,486.0
Property, Plant & Equipment	108,714.0	82,669.0	66,734.0	65,675.0	62,683.0
Intangible Assets	0.0	0.0	0.0	0.0	0.0
Other Non-current Assets	6,629.0	4,603.0	3,045.0	1,897.0	10,867.0
TOTAL ASSETS	**139,907.0**	**103,975.0**	**84,326.0**	**78,762.0**	**82,684.0**
LIABILITIES					
Short-term Debt (inc. CPLTD)	6,342.0	6,560.0	2,565.0	8,202.0	10,768.0
Accounts Payable/Trade Creditors	6,223.0	3,599.0	1,801.0	1,261.0	1,963.0
Provisions	1,515.0	1,058.0	781.0	0.0	0.0
Other Short-term Liabilities	1,939.0	1,916.0	732.0	969.0	1,508.0
Other Long-term Liabilities	7,313.0	8,988.0	9,228.0	9,889.0	10,141.0
Long-term Secured Debt	0.0	0.0	0.0	0.0	0.0
Long-term Unsecured Debt	19,935.0	42.0	543.0	892.0	13,232.0
TOTAL LIABILITIES	**43,267.0**	**22,163.0**	**15,650.0**	**21,213.0**	**37,612.0**
EQUITY					
Minority Interest/Minorities	571.0	477.0	356.0	281.0	449.0
Equity Capital & Reserves	96,069.0	81,335.0	68,320.0	57,268.0	44,623.0
TOTAL LIABILITIES & EQUITY	**139,907.0**	**103,975.0**	**84,326.0**	**78,762.0**	**82,684.0**
Adjusted Gross Debt	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
Debt Schedule					
DEBT PRIORITY					
Lease Liabilities	0.0	0.0	0.0	0.0	0.0
Secured	0.0	0.0	0.0	0.0	0.0
Unsecured	26,277.0	6,602.0	3,108.0	9,094.0	24,000.0
Convertible	0.0	0.0	0.0	0.0	0.0
Subordinated	0.0	0.0	0.0	0.0	0.0
Total Debt	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
Off-Balance Sheet Debt	0.0	0.0	0.0	0.0	0.0
Total Adjusted Debt	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
Non-recourse + Equity Hybrid Component	0.0	0.0	0.0	0.0	0.0
Total Adjusted Debt with Equity Credit	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
Adjusted Liabilities~~	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
DEBT SOURCE					
Bank	26,277.0	6,602.0	3,108.0	9,094.0	24,000.0
Capital Markets	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
TOTAL DEBT	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
DEBT MATURITY					
Less than 1 Year	6,342.0	6,560.0	2,565.0	8,202.0	10,768.0
1 To 2 Years	13,242.0	42.0	501.0	735.0	7,920.0
2 To 5 Years	6,693.0	0.0	42.0	141.0	5,305.0
More than 5 Years	0.0	0.0	0.0	16.0	7.0
TOTAL DEBT	**26,277.0**	**6,602.0**	**3,108.0**	**9,094.0**	**24,000.0**
Unrestricted Cash & Deposits	10,992.0	3,982.0	5,668.0	2,956.0	3,003.0
CURRENT DEBT NET OF CASH	**-4,650.0**	**2,578.0**	**-3,103.0**	**5,246.0**	**7,765.0**
TOTAL DEBT NET OF CASH	**15,285.0**	**2,620.0**	**-2,560.0**	**6,138.0**	**20,997.0**
TOTAL ADJUSTED DEBT NET OF CASH	**15,285.0**	**2,620.0**	**-2,560.0**	**6,138.0**	**20,997.0**
Adjusted Liabilities Net of Cash	**15,285.0**	**2,620.0**	**-2,560.0**	**6,138.0**	**20,997.0**
Restricted Cash & Deposits	0.0	0.0	0.0	0.0	0.0

~ includes Restricted Cash
~~ Total Adjusted Debt with Equity Credit plus Debt-like Pref. Stock

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Summary Income Statement

	31 Dec 2008 RUBm Original	31 Dec 2007 RUBm Original	31 Dec 2006 RUBm Original	31 Dec 2005 RUBm Original	31 Dec 2004 RUBm Original
SUMMARY INCOME STATEMENT					
Revenue*	72,457.0	56,741.0	43,598.0	37,861.0	24,105.0
Cost of Goods Sold	25,499.0	19,765.0	15,657.0	10,652.0	7,650.0
GROSS PROFIT	**46,958.0**	**36,976.0**	**27,941.0**	**27,209.0**	**16,455.0**
Selling, Distribution & Administrative Expenses	5,064.0	3,873.0	3,165.0	2,417.0	1,605.0
Other Operating Expenditure**	5,340.0	4,004.0	1,895.0	1,913.0	5,773.0
Presentational only: L-T Rentals (incl. in SG&A above)	0.0	0.0	0.0	0.0	0.0
Operating EBITDAR	**36,554.0**	**29,099.0**	**22,881.0**	**22,879.0**	**9,077.0**
Depreciation & Amortisation	4,581.0	3,734.0	3,728.0	3,410.0	699.0
Non-recurring, non-operational and non-recourse income***	0.0	0.0	0.0	0.0	0.0
Associate Income/Loss	0.0	0.0	0.0	0.0	0.0
Other Income/Expense	0.0	0.0	0.0	0.0	0.0
EBIT	**31,973.0**	**25,365.0**	**19,153.0**	**19,469.0**	**8,378.0**
Interest Income	407.0	376.0	274.0	672.0	462.0
Interest Expense	222.0	263.0	516.0	1,121.0	863.0
Non-interest Financial Income/Charges	-3,569.0	11.0	211.0	-280.0	109.0
PBT	**28,589.0**	**25,489.0**	**19,122.0**	**18,740.0**	**8,086.0**
Taxation	5,662.0	6,761.0	5,115.0	5,078.0	2,118.0
Minorities	-28.0	8.0	72.0	35.0	-274.0
NET INCOME	**22,899.0**	**18,736.0**	**14,079.0**	**13,697.0**	**5,694.0**
Extraordinary Items/Accounting Changes	0.0	0.0	0.0	0.0	0.0
NET INCOME AFTER EXTRAORDINARY ITEMS (before dividends)	22,899.0	18,736.0	14,079.0	13,697.0	5,694.0

Summary Cash Flow

	31 Dec 2008 RUBm Original	31 Dec 2007 RUBm Original	31 Dec 2006 RUBm Original	31 Dec 2005 RUBm Original	31 Dec 2004 RUBm Original
SUMMARY CASH FLOW					
Operating EBITDAR	**36,554.0**	**29,099.0**	**22,881.0**	**22,879.0**	**9,077.0**
Cash Interest Paid, Net of Interest Income	213.0	-132.0	323.0	914.0	526.0
Cash Tax Paid	8,791.0	6,099.0	5,754.0	6,407.0	2,217.0
Associate Dividends	0.0	0.0	0.0	0.0	0.0
Other Changes before Funds From Operations****	1,236.0	82.0	343.0	-2,876.0	-1,468.0
FUNDS FROM OPERATIONS	**28,786.0**	**23,214.0**	**17,147.0**	**12,682.0**	**4,866.0**
Working Capital	2,515.0	-1,699.0	-532.0	-3,350.0	-575.0
CASH FLOW FROM OPERATIONS	**31,301.0**	**21,515.0**	**16,615.0**	**9,332.0**	**4,291.0**
Non-Operational Cash Flow***	-3.0	-340.0	-114.0	7,825.0	-8,372.0
Capital Expenditure	31,596.0	19,666.0	4,770.0	4,433.0	5,362.0
Dividends Paid	7,652.0	5,860.0	3,290.0	1,889.0	2,010.0
FREE CASH FLOW	**-7,950.0**	**-4,351.0**	**8,441.0**	**10,835.0**	**-11,453.0**
Receipts from Asset Disposals	0.0	0.0	0.0	0.0	0.0
Business Acquisitions	457.0	989.0	184.0	52.0	-298.0
Business Divestments	264.0	5.0	45.0	5,565.0	361.0
Exceptional & Other Cash Flow Items	0.0	0.0	0.0	0.0	0.0
NET CASH IN/OUTFLOW	**-8,143.0**	**-5,335.0**	**8,302.0**	**16,348.0**	**-10,794.0**
Equity Issuance/(Buyback)	-599.0	0.0	0.0	0.0	0.0
FX movement	635.0	-12.0	-148.0	-12.0	-21.0
Other Items Affecting Cash Flow****	-4,558.0	167.0	544.0	-1,477.0	-3,979.0
NET CASH FLOW AVAILABLE FOR FINANCING	**-12,665.0**	**-5,180.0**	**8,698.0**	**14,859.0**	**-14,794.0**
OPENING TOTAL DEBT NET OF CASH	**2,620.0**	**-2,560.0**	**6,138.0**	**20,997.0**	**6,203.0**
Net Debt Increase/(Decrease)	12,665.0	5,180.0	-8,698.0	-14,859.0	14,794.0
CLOSING TOTAL DEBT NET OF CASH	**15,285.0**	**2,620.0**	**-2,560.0**	**6,138.0**	**20,997.0**

* Net of Sales, Royalty & Other Operational Taxes
** Excludes Depreciation & Amortisation
*** Analyst Estimate
**** Balancing Item

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Ratio Analysis

	31 Dec 2008 RUBm Original	31 Dec 2007 RUBm Original	31 Dec 2006 RUBm Original	31 Dec 2005 RUBm Original	31 Dec 2004 RUBm Original
EARNINGS/PROFITABILITY					
Revenue Growth (%)	27.7	30.1	15.2	57.1	40.4
Gross Profit/Revenues (%)	64.8	65.2	64.1	71.9	68.3
Op. EBITDAR/Revenues (%)	50.4	51.3	52.5	60.4	37.7
EBIT/Revenues (%)	44.1	44.7	43.9	51.4	34.8
Pre-Tax Profit/Revenues (%)	39.5	44.9	43.9	49.5	33.5
Profit after tax/Revenues (%)	31.6	33.0	32.1	36.1	24.8
Effective Tax Rate (%)	19.8	26.5	26.7	27.1	26.2
Profit after tax/Average Equity (%)	32.0	33.9	30.3	36.5	17.9
Return on Average Assets (%)	19.0	20.2	17.8	18.3	8.3
FFO Return on Adjusted Capital (%)	23.6	26.6	24.6	20.7	8.3
Free Cash Flow Margin (%)	-11.0	-7.7	19.4	28.6	-47.5
COVERAGES					
FFO/Gross Interest Expense and Preferred Dividends (x)	130.7	89.3	34.2	12.3	6.6
FFO Fixed Charge Cover (x)	130.7	89.3	34.2	12.3	6.6
(Op. EBITDAR-Capex)/Gross Fixed Charges(x)	22.3	35.9	35.1	16.5	4.3
Op. EBITDAR/Net Fixed Charges (x)	-197.6	-257.5	94.5	51.0	22.6
FFO/Interest Expense Net of Interest Income (x)	-154.6	-204.4	71.9	29.2	13.1
Free Cash Flow Debt Service Coverage (x)	-1.2	-0.6	2.9	1.3	-0.9
Net Fixed Charges Cover (x)	-172.8	-224.5	79.1	43.4	20.9
LEVERAGE					
Total Adjusted Debt/Op. EBITDAR (x)	0.7	0.2	0.1	0.4	2.6
Total Adjusted Debt Net of Cash/Op. EBITDAR(x)	0.4	0.1	-0.1	0.3	2.3
Adjusted Liabilities Net of Cash/Op. EBITDAR (x)	0.4	0.1	-0.1	0.3	2.3
Adjusted Net Leverage/FFO (x)	0.5	0.1	-0.1	0.5	4.0
Adjusted Leverage/FFO (x)	0.9	0.3	0.2	0.7	4.2
Free Cash Flow/ Adjusted Liabilities (%)	-30.3	-65.9	271.6	119.1	-47.7
CFO/Total Debt Net of Cash (%)	204.8	821.2	-649.0	152.0	20.4
CFO/Adjusted Liabilities Net of Cash (%)	204.8	821.2	-649.0	152.0	20.4
Total Adjusted Debt/Total Adjusted Capitalisation (%)	21.4	7.5	4.3	13.6	34.7
FINANCIAL STRUCTURE					
Secured and Lease Debt/Total Debt (%)	0.0	0.0	0.0	0.0	0.0
Current Debt/Total Debt (%)	24.1	99.4	82.5	90.2	44.9
Off-Balance Sheet Debt/Total Adjusted Debt (%)	0.0	0.0	0.0	0.0	0.0
Total Debt Net of Cash/Tangible Equity (%)	15.8	3.2	-3.7	10.7	46.6
PENSION ADJUSTED RATIOS					
Mixed Scheme Pension Liability	0.0	0.0	0.0	0.0	0.0
Pension Adjusted Net Leverage	0.4	0.1	-0.1	0.3	2.3
Pension Adjusted Net Coverage	0.0	0.0	0.0	0.0	0.0
Pension Adjusted Net Coverage (Implied)	0.0	0.0	0.0	0.0	0.0
Implied Interest Cost	0.0	0.0	0.0	0.0	0.0
Pension Adjusted Gross Coverage	-389.6	-833.1	0.0	0.0	0.0
Pension Adjusted Gross Coverage (Implied)	0.0	0.0	0.0	0.0	0.0
WORKING CAPITAL CYCLE					
Average Inventory Processing Period (days)	28.3	33.3	37.7	40.2	44.3
Average Receivables Collection Period (days)	12.0	15.5	17.5	19.4	26.0
Gross Cash Cycle (days)	40.3	48.8	55.2	59.6	70.3
Average Payables Payment Period (days)	70.3	49.9	35.7	55.2	93.7
Cash Conversion Cycle (days)	-30.0	-1.0	19.5	4.4	-23.4
ADDITIONAL INFORMATION					
Depreciation	0.0	0.0	0.0	0.0	0.0
Amortisation	4,581.0	3,734.0	3,728.0	3,410.0	699.0
Capital Expenditure/Depreciation (x)	n.a.	n.a.	n.a.	n.a.	n.a.
CFO/Capital Expenditure (x)	1.0	1.1	3.5	2.1	0.8
Interest Capitalised	0.0	0.0	0.0	0.0	0.0
Hire/Lease/Rent Costs for Current Assets	184.0	146.0	123.0	59.0	95.0
Hire/Lease/Rent Costs for Long-term Assets	0.0	0.0	0.0	0.0	0.0
Contingent Liabilities	0.0	0.0	0.0	0.0	0.0
Operating Exceptionals in Operating Costs	0.0	0.0	0.0	0.0	0.0
Staff cost/Revenues (%)	7.5	7.2	6.5	5.7	8.3
R&D (net)/Revenues (%)	0.0	0.0	0.0	0.0	0.0