

Energy (Oil & Gas)
Russian Federation
Credit Update

OAO Novatek

Ratings

Foreign Currency		
Long-Term IDR	BBB-	
Senior Unsecured	BBB-	
Local Currency		
Long-Term IDR	BBB-	

Outlooks

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

Financial Data

OAO Novatek		
(RUBm)	31 Dec 08	31 Dec 07
Revenue	72,457	56,741
Operating EBITDAR	36,554	29,099
Op. EBITDAR/revenues (%)	50.4	51.3
Op. EBITDAR/fixed charges (x)	164.7	110.6
Cash flow from operations	31,301	21,515
Free cash flow	-7,950	-4,351
FFO/interest expense net of interest income (x)	-154.6	-204.4
Total debt	26,277	6,602
Closing net debt	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

- Applicable Criteria**
- *Corporate Rating Methodology (November 2009)*
 - *Oil and Gas Sector Exploration and Production Rating Methodology (October 2008)*

Rating Rationale

- OAO Novatek's (Novatek) Long-Term IDRs are supported by the company's 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'/Stable/'F3') 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. Fitch anticipates domestic gas prices in Russia to increase by c.20% 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 Vladimir Putin has expressed a desire to see this area developed; and the company hopes to do this in cooperation with its minority shareholder, Gazprom.
- Novatek's credit profile is challenged by its relatively small scale and lack of integration. Fitch Ratings expects the company 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.

What Could Trigger a Rating Action?

- Achieving a development strategy for Yamal LNG with Gazprom that does not jeopardise Novatek's financial profile would be positive for the ratings.
- 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 ratings.
- The ratings 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

Gross production for Q409 totalled 8.98 billion cubic meters (bcm) of natural gas and 834,000 tons of liquids (gas condensate and crude oil). Natural gas production increased by 923 million cubic meters, or by 11.4%, and gross liquids production increased by 126,000 tons, or by 17.8%, compared with the corresponding gross production in Q408.

Liquidity and Debt Structure

At end-September 2009, Novatek had about USD100m of cash on balance sheet deposited with highly rated international banks. The company also had available short-term credit facilities totalling USD400m, of which USD324m was undrawn. This compares with short-term debt obligations of USD533m. Leverage remains low, with net debt/EBITDA of 1.0x in the 12 months to end-September 2009. Other leverage metrics, such as net debt to total capitalisation, also remain low relative to peers. For example, in September 2009, Novatek's net debt/total capitalisation ratio was 21%, below that of other major European international oil companies, whose target ratios tend to be 20%-30% and can at times reach 40%.

Peer Group

Issuer	Country
BBB	
OAO Gazprom	Russian Federation
BBB-	
OAO LUKOIL	Russian Federation
Rosneft	Russian Federation
TNK-BP International Ltd.	Russian Federation
BB	
OAO Tatneft	Russian Federation

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
19 Oct 09	BBB-	Stable
9 Oct 09	BBB-	Stable

Source: Fitch

Snapshot Profile: Major Rating Factors and Trends for OAO Novatek

Rating factor	Status ^a	Trend
Operations	Average	Neutral
Market position	Average	Neutral
Finances	Strong	Neutral
Governance	Strong	Neutral
Geography	Weak	Improving

^a Relative to Russian peer group
Source: Fitch

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Due to its large industrial base and cold winter climate, Russia is the second-largest global consumer of natural gas after the US. In 2009, Russia's domestic gas consumption amounted to 395.8 billion cubic meters, down approximately 4.2% on the year. Natural gas accounts for more than 50% of the country's primary energy supply and in some regions accounts for 80%. Although Novatek's share of the total Russian gas market is relatively small (it supplies 5% of Russia's total natural gas output and about 8% of domestic demand) it has the largest market share among independent producers, 28% of Russian independent gas production. 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.

2008 Peer Group Operating Metrics

	Novatek	TNK-BP	Rosneft	LUKOIL
Finding and development costs (USD/boe)	2.73	7.50	11.22	-15.62 ^a
Oil and gas produced (mm boe/day)	0.547	1.640	2.112	2.182
EBITDAX per boe (USD)	7.6	16.7	22.4	21.5
Adjusted total debt/proved reserves (USD/boe)	0.20	0.99	1.94	0.72

LUKOIL based on PRMS, others based on SEC-LOF excluding equity affiliates and JVs

^a negative F&D costs per barrel indicate expenditure in the year without incrementally increasing reserves

Source: Fitch, companies' data

Key Credit Characteristics

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 expand investment into exploration and development initiatives.

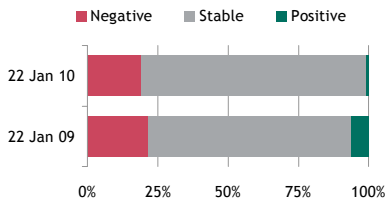
Overview of Companies

- **OAO Novatek:** Novatek is Russia's largest independent natural gas producer, and the second-largest producer of natural gas overall after Gazprom. The company has plans to increase annual production capacity to 45bcm by 2010 and to 65bcm by 2015.
- **OJSC OC Rosneft:** Russia's second largest oil and gas producer at 2.12 million boe/d (excluding its share in equity affiliates). In 2008, crude oil exports excluding the CIS accounted for 48.5% of total revenue (with China accounting for about 11% of that amount).
- **OAO LUKOIL:** Russia's largest oil and gas producer at 2.18 million boe/d (excluding its share in equity affiliates). A growing production region in LUKOIL's portfolio is the Timan-Pechora region. LUKOIL also has a growing international presence in downstream refining and marketing through acquisitions in Italy and the Netherlands.
- **TNK-BP International Ltd.:** Russia's third-largest oil and gas producer at 1.64 million boe/d (excluding equity affiliates such as Slavneft). TNK-BP has five refineries (four in Russia and one in Ukraine) with a total refining capacity of 782 mbpd at end-2008, including a 50% share in the Yanos refinery.

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

Distribution of Sector Outlooks

Directional Outlooks and Rating Watches



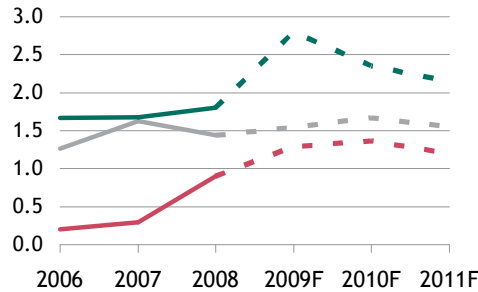
Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. The key assumptions used in arriving at these expectations are:

- profitability is maintained by the company's unique business position;
- cash flow generation is in line with profitability;
- investment requirements rise in line with new project development; and
- liquidity is supported by adequate cash balances and sufficient credit lines.

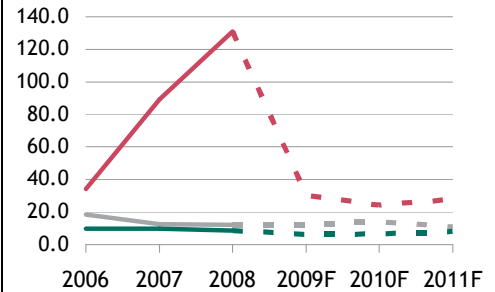
Definitions

- **Leverage:** lease adjusted gross debt with equity credit divided by funds from operations + interest
- **Interest cover:** FFO+ gross interest + capitalised interest divided by gross interest + capitalised interest
- **FCF/revenues:** free cash flow after dividends divided by revenues.
- **FFO profitability:** FFO divided by revenues
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's special report "Interpreting the new EMEA and Asia Pacific Corporates CU format" available at www.fitchratings.com

Leverage
including Fitch expectations



Interest Cover
including Fitch expectations

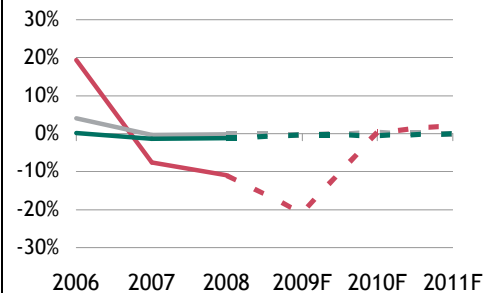


Debt Maturities and Liquidity at end-2008

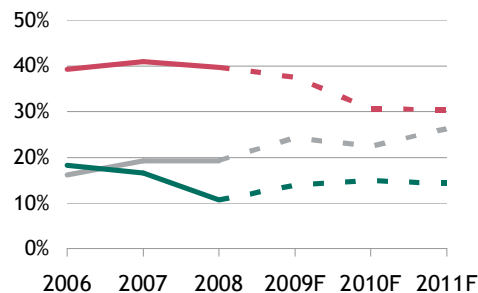
Debt maturities	(RUBm)
Less than 1 year	6,342
1-2 years	13,242
2-5 years	6,693
More than 5 years	0
Cash and equivalents	10,992

Source: Fitch

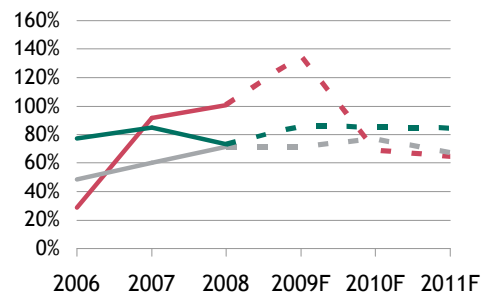
FCF/Revenues
including Fitch expectations



FFO Profitability
including Fitch expectations

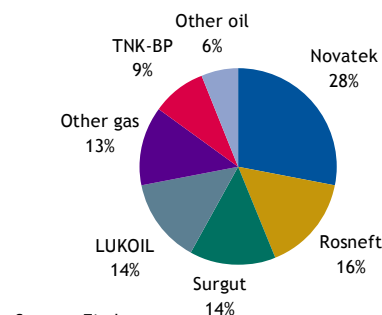


Capex/CFO
including Fitch expectations



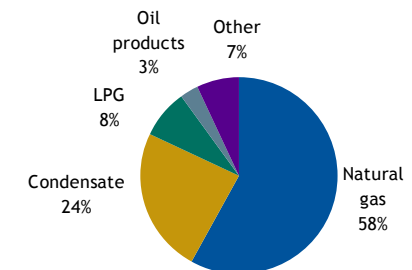
Novatek Market Share

December 2009



Source: Fitch

Novatek Revenues by Product



Source: Novatek, Fitch

Existing Financial Spread Data

QAO Novatek Financial Summary

	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
INCOME STATEMENT					
Revenues	72,457.0	56,741.0	43,598.0	37,861.0	24,105.0
Revenue Growth	27.7	30.1	15.2	57.1	40.4
EBIT	31,973.0	25,365.0	19,153.0	19,469.0	8,378.0
Interest Expense Net of Interest Income	-185.0	-113.0	242.0	449.0	401.0
Net Income	22,899.0	18,736.0	14,079.0	13,697.0	5,694.0
BALANCE SHEET					
Cash and Equivalents	10,992.0	3,982.0	5,668.0	2,956.0	3,003.0
Total Assets	139,907.0	103,975.0	84,326.0	78,762.0	82,684.0
Short-term Debt	6,342.0	6,560.0	2,565.0	8,202.0	10,768.0
Senior Long-Term Debt	19,935.0	42.0	543.0	892.0	13,232.0
Subordinated Debt	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
Common Equity	96,069.0	81,335.0	68,320.0	57,268.0	44,623.0
Off-Balance Sheet Debt	0.0	0.0	0.0	0.0	0.0
Total Adjusted Capitalisation	122,917.0	88,414.0	71,784.0	66,643.0	69,072.0
Total Adjusted Debt	26,277.0	6,602.0	3,108.0	9,094.0	24,000.0
Preferred Stock + Minority Interests	571.0	477.0	356.0	281.0	449.0
CASH FLOW					
Operating EBITDAR (Op. EBITDAR)	36,554.0	29,099.0	22,881.0	22,879.0	9,077.0
Cash Interest Paid, Net of Interest Received	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
CLOSING NET DEBT	15,285.0	2,620.0	-2,560.0	6,138.0	20,997.0
PROFITABILITY					
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
FFO Return on Adjusted Capital (%)	23.6	26.6	24.6	20.7	8.3
CREDIT RATIOS					
Funds From Operations/Gross Interest Expense (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/Net Fixed Charges (x)	-197.6	-257.5	94.5	51.0	22.6
Adjusted Leverage/FFO (x)	0.9	0.3	0.2	0.7	4.2
Total Adjusted Debt Net of Cash/Op. EBITDAR (x)	0.4	0.1	-0.1	0.3	2.3
Total Adjusted (Recourse) Debt/Total Adjusted Capitalisation (%)	21.4	7.5	4.3	13.6	34.7

Off Balance sheet debt reflects 8 times gross rent expense plus off balance sheet debt with full/limited recourse.

* Includes Analyst Estimate

** Balancing Item

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