

Rating Action: Moody's upgrades Novatek to Baa3 with a Stable outlook

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London, 01 August 2007 -- Moody's Investors Service has upgraded the Corporate Family Ratings of OAO Novatek ("Novatek") to Baa3 from Ba2, thus into investment grade. As part of the upgrade of the Corporate Family Ratings ("CFR") into investment grade territory, the CFRs have been changed to Issuer ratings. The outlook is stable. Concurrently, Moody's Interfax Rating Agency has upgraded Novatek's National Scale Rating (NSR) long term rating to Aaa.ru from Aa2.ru. Moscow-based Moody's Interfax is majority-owned by Moody's Investors Service, a leading global rating agency.

Moody's last rating action on Novatek was on 10 February 2006, when the first time rating was assigned.

Today's upgrades follow Novatek's consistent track record of exceptionally strong operational and financial performance, as well as Moody's view that the operating environment for privately owned Russian oil and gas companies in general, and for Novatek in particular, has stabilised over the past two years, thus reducing the impact on Novatek's fundamental credit quality. In Moody's view Novatek's business risk profile has been strengthened by the acquisition by Gazprom of 19.4% of Novatek's shares in December 2006 which reduced the risks relating to UGSS pipeline access and competition with Gazprom. In the agency's opinion, Novatek, which is the second largest domestic gas producer, is also well positioned to benefit from gradual liberalisation of the Russian gas market supported by growing domestic demand for gas which is expected to be increasingly met by independent gas producers in view of Gazprom's strategic focus on exports.

Moody's states that the upgrade of Novatek's rating is a reflection of (1) its substantial reserve based and the company's successful efforts to convert undeveloped reserves into developed (2) its very high operating and capital efficiency when compared to Russian as well as international peers, (3) limited exposure to commodity price risk given low prices of domestic Russian gas, (4) strong growth prospects from increasing domestic demand, tighter supply and state gas price liberalisation programme, (5) increased diversification of Novatek's revenue base through commissioning and operation of Purovsk gas condensate plant, (6) Novatek's clear and transparent group structure supported by ongoing efforts to improve corporate governance and reporting transparency, (7) the company's well-articulated and prudent financial policies and conservative capital structure as well as (8) Moody's expectation that Novatek will maintain a robust financial profile going forward and will continue delivering on its operational and financial targets.

At the same time, Moody's adds that Novatek's ratings remain constrained by (1) the company's continued high dependence on state-owned OJSC Gazprom for pipeline access and the latter's effective control of the Russian gas sector (2) high geographical concentration of Novatek's reserve base, (3) a certain degree of customer concentration risk and (4) wider geopolitical risks from operating solely in Russia.

The stable outlook reflects Moody's expectation that for the next 12-18 months Novatek's focus will be on the implementation of its growth strategy, capital expenditure programme and optimisation of its capital structure. To support the ratings, Moody's expects the company to produce strong free cash flow after sustaining CAPEX going forward, adequate to cover Novatek's growing capital investments and dividends, while maintaining healthy cash balances.

Ratings could experience upward pressure, if Novatek is able to maintain its productive working relationship with Gazprom consistently, even under more attractive domestic market conditions, and upon coming closer to its 2010 production target of 45 billion cubic meters (bcm), while strongly outperforming above financial parameters. Moody's would also expect a larger overall number of longer term gas supply contracts with a somewhat more diversified customer base before ratings could benefit. At the same time, ratings could come under pressure, if Novatek were repeatedly unable to find transportation access to the UGSS for its gas or were otherwise impaired from undertaking its operations. Ratings could also come under pressure, if there was a material change in financial policy, which would result in substantial deterioration of cash flow and leverage metrics; nonetheless ratings do allow for some flexibility to increase investments or for higher shareholder returns, provided they are adopted in the context of expected financial parameters.

OAO Novatek, based in Moscow, is Russia's second largest gas company after state-controlled Gazprom, and the largest of the country's independent gas producers. In 2006 Novatek reported sales volumes of 28.7 billion cubic meters (bcm) of natural gas all of which is sold domestically and 2.34 million tonnes (mt) of liquid products (stable gas condensates, LPG and crude oil) of which about 60% is attributable to production of stable gas concentrate that the company exports. Total revenues in 2006 amounted to RUB 48.8 billion (USD 1.8 billion).

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