

July 7, 2009

Research Update:

OAO NOVATEK Outlook Revised To Positive On Continuing Output Volume Growth; 'BB+' Rating Affirmed

Primary Credit Analyst:

Per Karlsson, Stockholm (46) 8-440-5927; per_karlsson@standardandpoors.com

Secondary Credit Analyst:

Andrey Nikolaev, CFA, Moscow (7) 495-783-4131; andrey_nikolaev@standardandpoors.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings List

Research Update:

OAO NOVATEK Outlook Revised To Positive On Continuing Output Volume Growth; 'BB+' Rating Affirmed

Overview

- Russia-based gas producer OAO NOVATEK has demonstrated continued volume growth in 2009. Furthermore, we expect the company's capital spending to be more flexible, its financial metrics to remain favorable and its profitability strong.
- We have revised the outlook on the company to positive and affirmed the 'BB+' long-term credit rating.
- The positive outlook reflects the possibility that the rating could be raised if NOVATEK's high volumes prove sustainable.

Rating Action

On July 7, 2009, Standard & Poor's Ratings Services revised its outlook on OAO NOVATEK, Russia's largest independent natural gas producer, to positive from stable, following a review of the company's financial and operating performance. At the same time, the 'BB+' long-term corporate credit rating and the 'ruAA+' Russia national scale rating were affirmed.

Rationale

The outlook revision reflects the company's continued volume growth, long track record of operations alongside the dominant state-controlled OAO Gazprom (BBB/Negative/--), flexible capital spending program, and strong profitability. It also reflects our expectations that NOVATEK's financial metrics will remain favorable, as well as the gradually improving fundamentals of the Russian gas industry. The company's reported total debt as at March 31, 2009 stood at Russian ruble (RUR) 30.8 billion.

In the past few quarters we have been positively surprised by NOVATEK's continued year-on-year volume growth. Although these growth rates are lower than previously recorded, we notice a clear difference with most other Russian gas producers, which have been reporting shrinking volumes.

The outlook revision also reflects our expectations that NOVATEK's credit metrics will remain strong. Although the company plans capital spending of about RUR18 billion, after having completed two large projects in the fourth quarter of 2008 (the second phase of the Yurkharovskoye field and the second phase of the Purovsky plant) we take comfort from the fact that only a small part of the spending program is now committed. Although capital spending may still be high, we expect that management will act to ensure that net debt to EBITDA remains at about 1x over the cycle. No further major acquisition is

expected following the recent acquisition of a 51% stake in oil and gas exploration and production company OAO Yamal LNG.

We view it as positive that NOVATEK continues to demonstrate its ability to manage domestic gas industry risk, including very low domestic gas prices (compared with international benchmarks) and its operational dependence on Gazprom. Although we continue to view these risks as key rating constraints, NOVATEK has a long track record without any operating setbacks. In addition, we view Gazprom's 19.4% ownership of NOVATEK as a strong mitigating factor. Gazprom is represented by two directors on NOVATEK's board and has approved key strategic moves, such as the OAO Yamal LNG stake acquisition.

NOVATEK's very low production costs (\$0.66/barrel of oil equivalent in 2008), together with a degree of diversification between gas, stable gas condensate, and liquid petroleum gas, help to mitigate its exposure to low prices and enabled the company to generate a solid EBITDA margin of 41% in the first quarter of 2009 (47% in full year 2008). Although NOVATEK cannot export gas, the semiregulated nature of Russian domestic gas prices effectively limits the company's exposure to downside commodity price risk. Potential risks associated with Gazprom's dominant and privileged position in the Russian natural gas market--with 85% of the country's gas production, ownership of the pipelines and monopoly on gas exports--are essentially mitigated by Gazprom's economic interest in having independent producers such as NOVATEK satisfy growing domestic demand at low prices, thereby enabling Gazprom itself to boost its profitable exports. NOVATEK is set to benefit from gradually increasing domestic gas prices, even if gas transportation tariffs and gas production taxes also increase.

NOVATEK's large reserve base (4.96 billion barrels of oil equivalent at year-end 2008 under SEC standards.) supports considerable opportunities for organic growth. In 2008, the company produced 30.88 billion cubic meters of gas, a 8.3% increase on 2007.

Liquidity

NOVATEK's liquidity position is adequate. Cash in hand stood at RUR14 billion at the end of March 2009. We understand that the company has access to committed credit facilities of \$350 million until 2010. We further understand that the company is in the process of signing further committed facilities of about \$300 million. Once this has been confirmed, we will factor it into our credit assessment. At March 31, 2009, short-term debt and the current portion of long-term debt stood at RUR11.6 billion. The company has to part finance the 51% acquisition of OAO Yamal LNG, in total \$550 million during 2009. We understand that management plans to issue US\$300 million Russian ruble notes in the second half of 2009. Longer-term finance would help underpin the credit profile when the issue takes place.

We expect the company to remain in line with its key covenants; net debt to EBITDA below 3x and EBITDA interest coverage above 4x.

Outlook

The positive outlook reflects our view that a one-notch upgrade may be warranted in the short to medium term provided NOVATEK's business model continues to enable the company to maintain its volumes. However, this would require NOVATEK to continue to demonstrate a prudent financial policy, keeping net debt below annual EBITDA and adjusting its capital expenditure accordingly. We would also look for successful placement of the planned US\$300 million Russian ruble notes.

On the other hand, were volumes to decrease or profitability to decline for any reason we would probably revise the outlook to stable. Financial policy slippages, adverse regulatory changes, or evidence of operational risks such as adverse tariff or taxation moves, restrictions on access to gas or condensate transportation could put downward pressure on the outlook or ratings, although we do not consider this in our base-case scenario. We do not factor in significant acquisitions in 2009 and factor in only minor acquisitions in 2010.

Ratings List

Ratings Affirmed; Outlook Action

	To	From
OAO NOVATEK		
Corporate Credit Rating	BB+/Positive/--	BB+/Stable/--
Russia National Scale Rating	ruAA+/--/--	

Additional Contact:

Industrial Ratings Europe;CorporateFinanceEurope@standardandpoors.com

Ratings information is available to RatingsDirect subscribers at www.ratingsdirect.com. It can also be found on Standard & Poor's public Web site at www.standardandpoors.com; select your preferred country or region, then Ratings in the left navigation bar, followed by Find a Rating. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4011.

Copyright © 2011 by Standard & Poors Financial Services LLC (S&P), a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.