

Rating: Buy  
 S&P 500: 1285

## **Gazprom**

### **Raise Net Present Value to \$140 a Share**

<i>Symbol</i>	(OGZD) OGZPF	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	31,800
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	87.00	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	1/30/06	<i>Adjusted Reserves/Production NTM</i>	20.0
<i>Shares (mm)</i>	2,266	<i>EV/Ebitda</i>	6.4
<i>Market Capitalization (US\$m)</i>	197,200	<i>PV/Ebitda</i>	10.2
<i>Debt (US\$m)</i>	7,400	<i>Undeveloped Reserves (%)</i>	71
<i>Enterprise Value (EV) (US\$m)</i>	204,600	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	9.96
<i>Present Value (PV) (US\$m)</i>	324,700	<i>Present Value Proven Reserves(US\$/boe)</i>	2.98
<i>Net Present Value (US\$/share)</i>	140	<i>Present Value Proven Reserves(US\$/mcf)</i>	0.50
<i>Debt/Present Value</i>	0.02	<i>Earnings Next Twelve Months (US\$/sh)</i>	8.36
<i>McDep Ratio - EV/PV</i>	0.63	<i>Price/Earnings Next Twelve Months</i>	10
<i>Dividend Yield (%/year)</i>	0.5	<i>Indicated Annual Dividend (US\$/sh)</i>	0.42

Note: The Russian government owns about 50% of the equity.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

### **Summary and Recommendation**

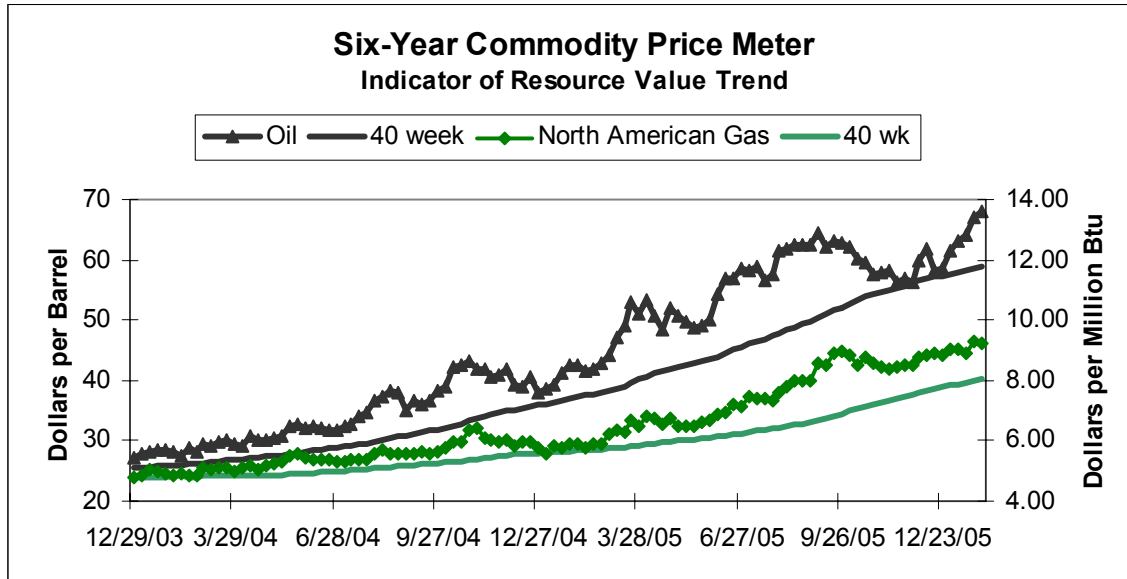
We raise our estimate of net present value of buy-recommended **Gazprom (OGZPF)** to \$140 a share from \$120 following the release of results for the third quarter of 2005 on January 30. Natural gas price and cash flow multiple outline potential appreciation of eight times from current stock price. The company's average natural gas selling price near \$2 a million btu in the quarter just reported, would average about \$3.50 in 2006 by our projections. To be equivalent to the new high futures price of \$70 a barrel for oil delivered over the next twelve months, natural gas would be \$14 a million btu, or four times what we expect for Gazprom in 2006. The company's rich resource position likely could ultimately justify an unlevered cash flow multiple, EV/Ebitda of perhaps twice its current 6.4 times on 2006 estimates. Meanwhile the administrative details are being worked out to trade shares more widely in the U.S. Also within several months, the weighting of Gazprom stock in the main international equity index is expected to increase from some 0.4% to about 3.7% as reported by Bloomberg and others.

### **McDep Ratio Understates Opportunity**

Six-year oil futures are about \$68 a barrel. Momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Six-Year Commodity Price Meter](#)). Our vision of \$150 oil in 2010 implies \$30 natural gas. Though that may seem out of sight, natural gas producers in the U.S. in the 1970s eventually realized gains of a similar magnitude.

The lowest McDep Ratio of buy-recommended stocks tells us that Gazprom's market cap and debt, or enterprise value, is well below estimated present value of its energy resources (see table [Rank by McDep Ratio](#)). Present value is linked to next twelve months cash flow and a multiple that depends on reserve life. That cash flow base in turn relates to a natural gas price of about \$3.50 a million btu. The cash flow multiple relates to a reserve life arbitrarily limited to 20 years.

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**Rank by McDep Ratio: Market Cap and Debt to Present Value**

	Symbol/ Rating	Price (\$/sh) 30-Jan 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Producer/Refiners - Large Cap and Mid Cap</b>							
Kinder Morgan, Inc.	KMI S2	96.70	139	13,480	33.00	0.74	1.50
Imperial Oil Limited (30%)	IMO B	104.63	102	10,690	84.00	0.10	1.22
Petro-Canada	PCZ B	48.33	523	25,280	42.00	0.19	1.12
Suncor Energy	SU B	79.29	461	36,560	75.00	0.10	1.05
Marathon Oil Corporation	MRO B	76.55	368	28,160	75.00	0.25	1.02
Norsk Hydro ASA	NHY B	121.84	251	30,570	130.00	0.17	0.95
PetroChina Company Ltd (10%)	PTR B	99.93	176	17,570	120.00	0.01	0.83
Lukoil Oil Company	LUKOY B	77.50	830	64,000	100.00	0.01	0.78
Gazprom (50%)	OGZPF B	87.00	1,133	98,600	140.00	0.02	0.63
<i>Total or Median</i>				325,000		0.10	1.02

**Low Cash Flow Multiple**

Gazprom's adjusted reserve life index of 20 years is highest among peers (see table Rank by EV/Ebitda). In our adjustment for correlation purposes, we arbitrarily limit any resource to 20 years. Gazprom's unlevered multiple, EV/Ebitda, is higher than some peers, but amply justified by reserve life.

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**Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.**

	Symbol/ Rating		Price (\$/sh) 30-Jan 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	96.70		8.2	12.3	19	3.6
Imperial Oil Limited (30%)	IMO	B	104.63	11.5	6.6	8.1	14	0.8
Suncor Energy	SU	B	79.29	17.7	7.3	7.7	15	0.3
Gazprom (50%)	OGZPF	B	87.00	20.0	10.2	6.4	10	0.5
Petro-Canada	PCZ	B	48.33	6.0	5.1	5.7	10	0.7
Norsk Hydro ASA	NHY	B	121.84	7.9	5.2	4.9	10	2.4
PetroChina Company Ltd (10%)	PTR	B	99.93	13.8	5.8	4.8	10	3.8
Marathon Oil Corporation	MRO	B	76.55	6.5	4.6	4.7	7	1.7
Lukoil Oil Company	LUKOY	B	77.50	19.7	5.5	4.3	6	1.3
	<i>Median</i>			<i>12.7</i>	<i>5.8</i>	<i>5.7</i>	<i>10</i>	<i>1.3</i>

**Most Concentration on Natural Gas**

Gazprom's 100% concentration on natural gas is unique among peers (see table [Business Segments](#)). In future quarters when we see more detail of recent acquisitions we expect to be able to identify noticeable concentration on oil.

**Home Country and Business Segments**

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Gazprom	OGZPF	B	Russia		100			325,000
PetroChina Company Ltd.	PTR	B	China	-	9	71	20	213,000
Lukoil Oil Company	LUKOY	B	Russia	-	-	75	25	83,600
Norsk Hydro ASA	NHY	B	Norway	-	29	38	33	39,200
Suncor Energy	SU	B	Canada	4	-	89	7	38,300
Marathon Oil Corporation	MRO	B		13	7	40	41	36,600
Imperial Oil Limited	IMO	B	Canada	13	-	62	25	31,900
Petro-Canada	PCZ	B	Canada	23	4	53	20	27,200
	<i>Median</i>			<i>4</i>	<i>5</i>	<i>62</i>	<i>25</i>	<i>795,000</i>

**Correlation Verifies Present Value in Real Time**

Our underlying quantitative method for estimating present value projects cash flows years into the future and brings them to the present by applying a real discount rate, currently 7% a year. Around that traditional discounted cash flow analysis (DCF) we deal with uncertainty on a qualitative basis. "Option value" to us, for example, is "upside potential". After awhile DCF analyses fall into a pattern where differences among companies depend mostly on first year cash flow and reserve life. Meanwhile input information is continually changing as companies make new disclosures, each on a different day or at a different hour and commodity prices fluctuate.

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We aggregate latest information into a correlation analysis that determines a real-time present value approximation. When that approximation deviates too much from our steady, official estimate of present value and we cannot justify the difference with company-specific explanation, we change the official estimate.

Though Gazprom is not in our correlation we have applied the coefficients determined from other companies as a check. Net present value indicated by the current correlation is about \$5 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value). In other words, our current estimate of present value can be justified on 2006 cash flow without counting on the continued catch up to global commodity pricing that we expect.

<b>Gazprom</b>					
<b>Functional Cash Flow and Present Value</b>					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
Natural Gas	31,900	20.0	10.2	324,700	
Oil					
Downstream					
	31,900		10.2	324,700	100%
Debt (US\$mm)					7,400
Net Present Value (US\$mm)					317,300
Shares (mm)					2,266
Net Present Value - Standard Estimate (US\$/sh)					140
Net Present Value - Approximation by Correlation (US\$/sh)					145

### **Futures Prices Propel Estimated Cash Flow by Quarter**

Cash flow for the next year is projected from a base through the latest reported quarter (see table Next Twelve Months Operating and Financial Estimates). Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year.

### **Index Changes May Stimulate Added Demand for Gazprom Stock**

A large shift in the allocation of U.S. investment funds to international markets continues at a rapid pace with sound justification. Much of the public investment finds its way to funds that are guided by an index of floating stock market capitalization. One well-known index compiled by Morgan Stanley Capital International (MSCI) said to be used in the management of \$3 trillion would increase the weighting of Gazprom from 0.4% to 3.7%. If that were to be the case, one could postulate \$100 billion of incremental demand for a stock with total capitalization that has reached about \$200 billion, partly in anticipation.

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**Gazprom**  
**Operating and Financial Results**

	Q3	Q4	Q2	Q3	Q4E	Year	Q1E	Q2E	Q3E	Q4E	Next Twelve Months
	9/30/04	12/31/04	6/30/05	9/30/05	12/31/05	2005E	3/31/06	6/30/06	9/30/06	12/31/06	12/31/06
<b>Volume</b> (billion cubic meters)											
Europe	34.6	39.8	37.5	34.3	40.6	156	44.8	38.3	35.0	41.4	159
Former Soviet Union	18.1	18.2	17.2	22.6	18.2	77	19.2	17.2	22.6	18.2	77
Russia	46.4	96.3	55.9	48.6	96.3	307	106.2	55.9	48.6	96.3	307
Total (bcm)	99.1	154.3	110.6	105.5	155.1	540	170.2	111.4	106.2	155.9	544
Total (bcf)	3,498	5,447	3,904	3,724	5,475	19,080	6,007	3,931	3,748	5,504	19,190
Daily (bcfd)	38.0	59.2	42.9	40.5	59.5	52.3	66.7	43.2	40.7	59.8	52.6
Days	92	92	91	92	92	365	90	91	92	92	365
<b>Price</b> (Russian Rubles/thousand cubic meters)											
Europe	2.90	3.32	3.59	4.06	4.27	3.84	7.00	7.00	7.00	7.00	7.00
FSU	1.04	1.11	1.26	1.69	1.86	1.53	2.05	2.25	2.47	2.72	2.38
Russia	0.83	0.81	1.03	1.02	1.49	1.16	1.64	1.80	1.98	2.18	1.89
Total (RR/mcm)	1.59	1.49	1.93	2.15	2.26	1.99	3.09	3.66	3.74	3.52	3.46
Rubles/Dollar	29.17	28.49	28.10	28.52	28.15	28.15	28.15	28.15	28.15	28.15	28.15
Total (\$/mcf)	1.55	1.49	1.95	2.14	2.27	2.00	3.11	3.68	3.76	3.54	3.48
Henry Hub (\$/mmbtu)	5.75	7.10	6.76	8.56	13.00	8.65	10.04	9.54	9.77	10.72	10.02
<b>Revenue</b> (RUB billion)											
Europe	100.3	132.0	134.6	139.4	173.2	600	313.4	267.8	244.9	289.9	1,116
FSU	18.8	20.3	21.6	38.2	33.8	118	39.3	38.7	55.9	49.5	183
Russia	38.7	78.3	57.6	49.8	143.3	356	173.8	100.6	96.2	209.7	580
Total Natural Gas	157.7	230.6	213.8	227.3	350.3	1,074	526.5	407.1	397.1	549.1	1,880
Other	54.1	62.8	58.2	63.7	63.7	242.6	63.7	63.7	63.7	63.7	254.6
Total	211.9	293.5	272.0	291.0	413.9	1,316.1	590.1	470.7	460.7	612.8	2,134.4
<b>Expense</b>	125.1	183.1	150.6	150.1	240.1	721.7	342.3	273.0	267.2	355.4	1,237.9
<b>Ebitda</b> (RUB billion)	86.8	110.3	121.4	140.9	173.9	594.4	247.9	197.7	193.5	257.4	896.4
Deprec., Deplet., & A	21.2	32.6	26.2	25.9	35.8	123.1	38.7	28.8	28.5	39.4	135.4
Other non cash	2.1	(16.7)	6.9			4.0					-
<b>Ebit</b>	63.5	94.5	88.3	115.0	138.0	467.3	209.1	168.9	165.0	218.0	761.0
Interest	-	3.4	1.6	2.0	2.0	7.8	2.0	2.0	2.0	2.0	8.0
<b>Ebt</b>	63.5	91.1	86.7	113.0	136.0	459.5	207.1	166.9	163.0	216.0	753.0
Income Tax	15.6	25.6	25.5	33.0	39.7	130.4	60.5	48.7	47.6	63.1	219.9
<b>Net Income</b> (RUB billion)	47.9	65.5	61.2	80.0	96.3	329.1	146.6	118.1	115.4	152.9	533.1
<b>Shares</b> (billions)	20.1	20.2	20.3	22.7	22.7	21.4	22.7	22.7	22.7	22.7	22.7
Per share (RUB)	2.38	3.24	3.02	3.53	4.25	15.36	6.47	5.21	5.09	6.75	23.52
Ebitda Margin (NatGa	55%	48%	57%	62%	50%	55%	47%	49%	49%	47%	48%
Tax Rate	25%	28%	29%	29%	29%	28%	29%	29%	29%	29%	29%

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