

Rating: Buy
S&P 500: 1350

Gazprom

Russian Natural Gas Price Too Low

<i>Symbol</i>	OGZPY	<i>Ebitda Next Twelve Months ending 9/30/07 (US\$mm)</i>	37,400
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	42.88	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	10/4/06	<i>Adjusted Reserves/Production NTM</i>	24.0
<i>Shares (mm)</i>	5,695	<i>EV/Ebitda</i>	7.0
<i>Market Capitalization (US\$mm)</i>	244,000	<i>PV/Ebitda</i>	9.0
<i>Debt (US\$mm)</i>	15,700	<i>Undeveloped Reserves (%)</i>	73
<i>Enterprise Value (EV) (US\$mm)</i>	260,000	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	11.41
<i>Present Value (PV) (US\$mm)</i>	335,000	<i>Present Value Proven Reserves(US\$/boe)</i>	2.60
<i>Net Present Value (US\$/share)</i>	56	<i>Present Value Proven Reserves(US\$/mcf)</i>	0.43
<i>Debt/Present Value</i>	0.05	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.08
<i>McDep Ratio - EV/PV</i>	0.78	<i>Price/Earnings Next Twelve Months</i>	11
<i>Dividend Yield (%/year)</i>	0.5	<i>Indicated Annual Dividend (US\$/sh)</i>	0.22

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

Buy-recommended **Gazprom (OGZPY)** sold 37% more natural gas and realized only about one-fourth the price compared to all U.S. producers combined in the first quarter of 2006. In financial results for that period disclosed on October 3-4, the Russian energy company reported that despite the low natural gas price, it converted 51% of revenue to cash flow. Valuation is within the range for U.S. companies when we compare market cap and debt to estimated next twelve months cash flow (EV/Ebitda). Thus, there is four-fold appreciation potential if Gazprom's natural gas price were to reach the world level. That potential could be enhanced by recognition of long resource life just as it could be limited by political risk among other factors. Net present value of \$56 a share is only partial recognition of the promise. We give the stock the highest weighting of 9% in our illustrative energy portfolio. Finally, having seen the first full quarter of operations since the acquisition late last year of the Russian company, Sibneft, we allocate 13% of present value to oil, leaving 87% for natural gas.

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Gazprom
Operating and Financial Results

	<i>Q1</i>	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Next</i>
	<i>3/31/05</i>	<i>12/31/05</i>	<i>2005</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>2006E</i>	<i>Twelve</i>
									<i>Months</i>
									<i>9/30/07</i>
Volume (billion cubic meters)									
Europe	43.9	40.4	156	45.6	37.5	34.3	40.4	158	158
Former Soviet Union	19.2	17.6	77	28.8	17.2	22.6	17.6	86	86
Russia	106.2	96.3	307	111.5	55.9	48.6	96.3	312	312
Total (bcm)	169.3	154.3	540	185.9	110.6	105.5	154.3	556	556
Total (bcf)	5,976	5,447	19,051	6,562	3,904	3,724	5,447	19,637	19,637
Daily (bcfd)	66.4	59.2	52.2	72.9	42.9	40.5	59.2	53.8	53.8
Days	90	92	365	90	91	92	92	365	365
Price (Russian Rubles/cubic meters)									
Europe	3.48	4.77	3.97	5.01	5.01	5.01	5.01	5.01	5.01
FSU	1.26	1.39	1.42	2.13	2.13	2.13	2.13	2.13	2.13
Russia	0.99	1.01	1.01	1.11	1.11	1.11	1.11	1.11	1.11
Total (RR/cm)	1.67	2.04	1.92	2.22	2.59	2.60	2.25	2.37	2.37
Rubles/Dollar	27.84	28.71	28.29	28.13	27.18	26.80	27.60	27.43	27.60
Total (\$/mcf)	1.70	2.01	1.92	2.24	2.70	2.74	2.31	2.45	2.44
Henry Hub (\$/mmbtu)	6.27	13.00	8.65	8.97	6.81	6.58	5.76	7.03	7.13
Revenue (RUB billion)									
Europe	152.6	192.6	619	228.3	187.8	171.8	202.3	790	790
FSU	24.2	24.4	108	61.2	36.6	48.1	37.4	183	183
Russia	105.4	97.2	310	124.1	62.2	54.1	107.2	348	348
Total Natural Gas	282.2	314.2	1,038	413.6	286.6	273.9	346.9	1,321	1,321
Other	57.1	167.1	346.0	172.2	172.2	172.2	172.2	688.8	688.8
Total	339.2	481.3	1,383.5	585.8	458.8	446.1	519.1	2,009.8	2,009.9
Expense	181.0	316.5	798.1	285.3	223.4	217.3	252.8	978.8	978.9
Ebitda (RUB billion)									
Natural Gas				246.6	181.4	174.9	212.4	815.2	815.3
Oil				53.9	53.9	53.9	53.9	215.7	215.7
Total Ebitda	158.2	164.8	585.4	300.5	235.3	228.8	266.3	1,031.0	1,031.0
Deprec., Deplet., & A	35.2	32.8	120.1	46.5	28.8	28.5	36.1	139.9	150.3
Other non cash	(2.9)		4.0					-	-
Ebit	125.9	132.0	461.3	254.0	206.5	200.3	230.2	891.1	880.7
Interest	2.2	10.2	16.0	4.0	4.0	4.0	4.0	16.0	16.0
Ebt	123.7	121.8	445.3	250.0	202.5	196.3	226.2	875.1	864.7
Income Tax	32.1	43.6	134.2	64.8	52.5	50.9	58.6	226.8	224.1
Net Income (RUB billio)	91.6	78.3	311.1	185.2	150.0	145.5	167.6	648.3	640.6
Shares (billions)	50.2	56.9	53.5	56.9	56.9	56.9	56.9	56.9	56.9
Per share (RUB)	1.82	1.38	5.82	3.25	2.63	2.55	2.94	11.38	11.25
Ebitda Margin	47%	34%	42%	51%	51%	51%	51%	51%	51%
Tax Rate	26%	36%	30%	26%	26%	26%	26%	26%	26%

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Functional Cash Flow and Present Value

	<i>NTM Ebitda</i> <i>(US\$mm)</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i> <i>(US\$mm)</i>	
Natural Gas	29,574	24.0	9.8	290,000	87%
Oil	7,826	19.9	5.7	44,600	13%
Downstream					
	37,400	23.7	8.9	334,600	100%
Debt (US\$mm)					15,700
Net Present Value (US\$mm)					318,900
Shares (mm)					5,695
Net Present Value - Standard Estimate (US\$/sh)					56

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