

Rating: Buy
S&P 500: 1418

Gazprom **World's Greatest Energy Company**

<i>Symbol</i>	OGZPY	<i>Ebitda Next Twelve Months ending 9/30/07 (US\$mm)</i>	38,400
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	46.45	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	12/21/06	<i>Adjusted Reserves/Production NTM</i>	24.0
<i>Shares (mm)</i>	5,700	<i>EV/Ebitda</i>	7.4
<i>Market Capitalization (US\$mm)</i>	265,000	<i>PV/Ebitda</i>	8.8
<i>Debt (US\$mm)</i>	20,300	<i>Undeveloped Reserves (%)</i>	73
<i>Enterprise Value (EV) (US\$mm)</i>	285,000	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	11.53
<i>Present Value (PV) (US\$mm)</i>	340,000	<i>Present Value Proven Reserves(US\$/boe)</i>	2.64
<i>Net Present Value (US\$/share)</i>	56	<i>Present Value Proven Reserves(US\$/mcf)</i>	0.44
<i>Debt/Present Value</i>	0.06	<i>Earnings Next Twelve Months (US\$/sh)</i>	4.01
<i>McDep Ratio - EV/PV</i>	0.84	<i>Price/Earnings Next Twelve Months</i>	12
<i>Dividend Yield (%/year)</i>	0.2	<i>Indicated Annual Dividend (US\$/sh)</i>	0.09

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)**'s sales of natural gas are as large as Saudi Arabia's sales of crude oil in heating equivalent and superior in environmental quality. Yet Gazprom's selling price at about \$2.50 a million btu is only about one-fourth of Saudi Arabia's at some \$60 a barrel, or \$10 a million btu. In view of that price chasm one can hardly fault Russian President Putin for attempting to secure market value for a precious resource. Yet, Russia, unlike Saudi Arabia, offers ordinary investors as well as anyone who objects to a nearer-to-market price for clean energy the opportunity to participate in the producer profit by owning shares of what may become the "World's Greatest Energy Company". Meanwhile, results for the second quarter of 2006 reported according to international financial standards on December 21 confirm a modest one-third increase in natural gas price over the previous year (see table Operating and Financial Results). With continued progress there would be justification for upward revisions in estimated net present value, currently at \$56 a share, that amounts to a modest multiple of current cash flow from low natural gas price (see table Functional Cash Flow and Present Value).

Energy a Political Tool?

How can consumers justify paying Gazprom, the world's largest natural gas producer, \$2.50 a million btu for clean fuel while paying Saudi Arabia, the world's largest oil producer, \$10 a million btu for medium dirty fuel? Because the gap between realized price and market price for Russian natural gas is so wide we have little sympathy with the argument that energy is being used as a political tool. Instead President Putin's great contribution to his countrymen may be to recognize the value of Russia's energy resources and to take actions to realize that value for Russians rather than to give it away cheap. We believe that consumers are also better off in the long run if energy sells at market price that takes into account environmental characteristics.

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The choice we make when we recommend Gazprom is driven by resource value and concentration on the cleanest fuel. Political risk is there, but it needs to be put in a balanced perspective.

The World's Greatest Energy Company designation applies to Gazprom today only in the size of its clean fuel resources. The company is not there yet on a commodity market price basis, in operating efficiency, in transparency of financial results or in stock market value. The future price of freely traded Gazprom stock may be the most credible measure of the success of Russia in managing its clean energy asset for home and global benefit. In view of the great potential, investors can be patient.

Sakhalin II Project Agreement Reached

At the same time Gazprom announced second quarter earnings, buy-recommended **Royal Dutch Shell (RDS)** announced that it and its partners had reached agreement to sell a half interest in the Far Eastern oil and liquefied natural gas project, Sakhalin II, to Gazprom for \$7.5 billion. The deal resolves a dispute with the Russian government over a doubling of the estimated cost of the project to \$20 billion. It looks like the price covers a half share of the costs incurred so far and we presume Gazprom will pay its share of costs not yet incurred.

We don't like seeing that RDS has to give up half of its upside. Yet the effect is not a lot different than when Norway some thirty years ago raised its incremental tax rate on oil to near 80% and required that the state oil company be a partner in new deals. The net result of today's Sakhalin announcement for investors is the transfer of some possible future reward from publicly held Shell to half publicly held Gazprom.

Kurt H. Wulff, CFA

Gazprom					
Functional Cash Flow and Present Value					
	<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	29,386	24.0	9.2	270,000	80%
Oil	9,014	19.9	7.7	69,500	20%
Downstream					
	38,400	23.7	8.8	339,500	100%
Debt (US\$mm)				20,300	
Net Present Value (US\$mm)				319,200	
Shares (mm)				5,700	
Net Present Value - Standard Estimate (US\$/sh)					56

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Gazprom
Operating and Financial Results

	<i>Q2</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next</i>
	<i>6/30/05</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>3/31/07</i>	<i>6/30/07</i>	<i>Twelve</i>
									<i>Months</i>
									<i>12/31/07</i>
Volume (billion cubic meters)									
Europe	37.5	45.6	39.3	34.3	40.4	160	45.6	39.3	160
Former Soviet Union	17.2	28.8	22.3	22.6	17.6	91	28.8	22.3	91
Russia	55.9	111.5	59.3	48.6	96.3	316	111.5	59.3	316
Total (bcm)	110.6	185.9	120.9	105.5	154.3	567	185.9	120.9	567
Total (bcf)	3,904	6,562	4,268	3,724	5,447	20,001	6,562	4,268	20,001
Daily (bcfd)	42.9	72.9	46.9	40.5	59.2	54.8	72.9	46.9	54.8
Days	91	90	91	92	92	365	90	91	365
Price (Russian Rubles/cubic meters)									
Europe	3.59	5.01	5.09	5.09	5.09	5.07	5.09	5.09	5.09
FSU	1.26	2.13	1.85	1.85	1.85	1.94	2.55	2.23	2.26
Russia	1.03	1.11	1.13	1.13	1.13	1.12	1.22	1.24	1.20
Total (RR/cm)	1.93	2.22	2.55	2.57	2.25	2.37	2.38	2.67	2.47
Rubles/Dollar	28.10	28.13	27.18	26.80	26.33	27.11	26.33	26.33	26.33
Total (\$/mcf)	1.95	2.24	2.66	2.72	2.42	2.47	2.56	2.88	2.65
Henry Hub (\$/mmbtu)	6.76	8.97	6.81	6.58	6.57	7.23	7.15	7.26	7.12
Revenue (RUB billion)									
Europe	134.6	228.3	200.0	174.6	205.6	809	232.1	200.0	812
FSU	21.6	61.2	41.3	41.8	32.6	177	73.4	49.7	206
Russia	57.6	124.1	67.0	54.9	108.8	355	136.0	73.5	379
Total Natural Gas	213.8	413.6	308.3	271.3	347.0	1,340	441.6	323.3	1,397
Other	58.2	172.2	197.3	197.3	197.3	764.1	197.3	197.3	789.2
Total	272.0	585.8	505.6	468.6	544.3	2,104.3	638.9	520.6	2,186.3
Expense	150.6	285.3	278.2	257.8	299.5	1,120.9	340.3	277.3	1,174.1
Ebitda (RUB billion)									
Natural Gas		246.6	168.0	151.4	185.4	751.3	239.2	183.9	774.6
Oil		53.9	59.4	59.4	59.4	232.1	59.4	59.4	237.6
Total Ebitda	121.4	300.5	227.4	210.8	244.8	983.5	298.6	243.3	1,012.2
Deprec., Deplet., & A	26.2	46.5	34.0	33.6	36.1	150.2	51.2	37.4	161.6
Other non cash	6.9					-			-
Ebit	88.3	254.0	193.4	177.2	208.7	833.3	247.4	205.9	850.6
Interest	1.6	4.0	6.5	6.5	6.5	23.5	6.5	6.5	26.0
Ebt	86.7	250.0	186.9	170.7	202.2	809.8	240.9	199.4	824.6
Income Tax	25.5	64.8	50.6	46.2	54.8	216.4	65.2	54.0	223.3
Net Income (RUB billio)	61.2	185.2	136.3	124.5	147.5	593.4	175.7	145.4	601.4
Shares (billions)	20.3	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8
Per share (RUB)	3.02	8.13	5.98	5.46	6.47	26.04	7.71	6.38	26.38
Ebitda Margin	45%	51%	45%	45%	45%	47%	47%	47%	46%
Tax Rate	29%	26%	27%	27%	27%	27%	27%	27%	27%

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