



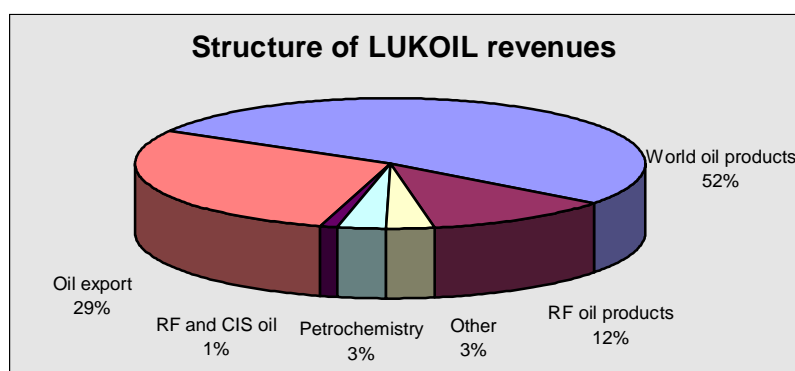
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RESEARCH

LUKOIL: Results for the 9 months of 2005 by US GAAP

On Friday LUKOIL issued consolidated results for the 9 months of 2005 by US GAAP. Thanks to high prices on oil and oil products and because of trade operations growth the revenues of the company increased by 66.2% as compared with the same factor of the last year and made \$40.24 bln. Here the receipts without mandatory payments (excises and export duties) and with the deduction of the cost of purchased oil have increased by 42% to \$19.4 bln.

The structure of revenues has got two tendencies. First, it is the decrease of revenues from raw oil sales and growth of portion of oil products sales. Thus, the portion of revenues from oil products realization grew from 58% to 63.1%, while the portion of revenues from oil sales dropped from 34.2% to 30.8%. This change was caused all by the decrease of oil export profitability thanks to high duties and growth of oil refining profitability. The second tendency lies in the growing orientation of LUKOIL onto Western markets – the portion of foreign sales makes 82.6%, while a year before it was just 78.9%.



Much important here is the growth of retail foreign sales: the physical volume has increased by one third up to 5.21 bln. tons. This growth became possible thanks to LUKOIL active policy concerning the expansion of retail trade networks. Thus, in 2005 the company has bought two retail trade networks in Finland - Oy Teboil Ab and Suomen Petrooli Oy, which occupy a large portion of Finnish market of oil products. The companies manage a network of 289 filling stations and 132 D-points (separate ground reservoirs and diesel fuel pumps). The expansion of retail trading provides for the growth of retail sales portion with favorable effect on financial results of the company.

The second direction of LUKOIL development is the increase of oil production outside Russian Federation. If in 2005 only 4.2% of the whole volume of oil production was extracted abroad, in 2006 the portion of foreign projects, on our estimations, will make 5.6%. And the main growth of foreign production will come through the acquisition of Nelson Resources company, which works at Kazakhstan territory. Note that the taxation of the oil industry in other countries is much lower than in Russia, so such projects are more cost-efficient.

At the same time the accounting has revealed some negative aspects. First, it is the increase of oil production cost from \$2.54 to \$2.72 for barrel. Growth of expenses was caused by the increase of maintenance costs and execution of actions in order to raise the recovery of oil beds. To our mind, the growth of oil production cost witnesses that main oil fields of the company have entered the stage of production decrease, so maintaining the production level will need more expenses. The second negative factor is the growth of expenses

on oil processing at Russian petroleum refineries (NPZ) – they have risen by 18.6%. This growth was caused by the putting into operation an refinery of the company in Romania in the fourth quarter 2004 year. On the whole operating expenses have increased by 13.1% and made \$2.38 bln.

And at last it is worth noting the 26% increase of commercial and general expenses of LUKOIL as compared with the same period of the last year. This increase was caused mainly due to the program of company's manager fees rise based on the growth of capitalization. During 9 months of 2005 for this program there was spent \$219 mln. against \$55 mln. the year before. It should be considered that LUKOIL capitalization in a year has increased more than twice what stipulated such record fees of managers. We suppose that this year the growth won't be so great, so this expense item will grow less. Acquisition of Finnish companies contributed the rise of commercial and general expenses. Their portion of expenditures made \$41 mln. If all these factors are deducted, the increase will be only 12.2%.

The 30% growth of tariffs for oil transportation on Transneft system was partly compensated by less growth of tariffs for railroad transportations (13.3%) and decrease of sea transportation cost by 9.3%. Growth of tariffs and increase of the total volume of sales resulted in the rise of transportation expenses by 21.3% to \$2.5 bln.

During the accounting period the pretax profit grew by 52.2% to \$6.6 bln. while net profit grew by 55.1% to \$4.8 bln. Much pleasure brought the decrease of the effective taxation rate from 28,7% to 27.3% that exceeded estimated 29%. Total effect of such decrease of the rate made \$112 mln. of additional income.

Note that on the third quarter totals the net income was \$2.2 bln. We consider that the last quarter of the last year would be less successful for the company due to the decrease of average world prices on Russian oil from \$57.20 to \$54.09 for barrel. That's why we retain our forecast of net income on 2005 totals at the figure of \$6.84 bln.

It should be admitted that in 2005 our forecast about oil prices was lower than real figures. We forecasted average price for Ural type oil as about \$50 for barrel, while the real figure was \$54.31 for barrel. Besides, we forecasted the decrease of the average price up to \$45 for barrel in 2006. However the latest events show that such a decrease is hardly possible. Among factors supporting oil quotations will be OPEC statements about the reduction of oil production in case of sharp fall of the price, recommencement of the nuclear program by Iran, difficulties with oil delivery from Nigeria. That's why we revised our forecast about oil prices in the direction of growth. In particular, we have increased our forecast about prices for Urals type oil from \$45 to \$50 for barrel in 2006, from \$42 to \$45 in 2007 and from \$39 to \$42 for barrel in 2008. Beside, the long-term forecast of oil prices was increased from \$36 to \$40 for barrel. Note that this forecast is also rather conservative. Besides revision of world oil prices we have increased home prices as well as prices for CIS countries. We have correlated our model of the estimation of the company value considering published paperwork and rise of forecasted prices. As a result, the forecasted net income of LUKOIL grew from \$5.9 bln. to \$8.5 bln. in 2006 and from \$5.6 bln. to \$7.3 bln. in 2007.

Forecast of financial results of LUKOIL(\$ mln)

	2004	2005*	2006*	2007*	2008*	2009*	2010*
Revenues (without trade operations)	23934	39643	42223	40021	39141	38989	40622
Excise and export tariffs	5428	12420	11233	10379	9994	9850	10337
Operating Expenses	2880	3270	3600	3950	4334	4756	5218
Transportation Expenses	2784	3400	3939	4369	4846	5374	5959
Selling, general and administrative expenses	2024	2510	2631	2763	2901	3046	3198
Taxes other than income taxes	3505	6837	6764	6041	5961	5979	6238
Depreciation, depletion and amortization	1075	1273	1500	1590	1661	1717	1757
Other expenses	381	221	350	370	390	400	400
Income before income taxes	6008	9404	11766	10118	8614	7427	7075
Net income	4248	6837	8472	7285	6202	5348	5094



On the reason of income revision we have changed the forecast of LUKOIL financial borrowings – we guess that the income of the company will allow it to fund all investment programs itself so the company needs not to attract borrowed assets this year. We have also reduced the estimation of its own capital value from 12.5% to 12.0%. As a result, the discount rate declined from 11.3% to 10.75%.

According to the new forecast about financial results the fair value of the company makes \$66.06 bln. or \$79.54 per share. Judging from current quotations, the growth potential is 12.1%, meaning **To Buy** recommendation.

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