

RUSSNEFT SUBS



RUSSIAN EQUITY RESEARCH

14 MARCH 2006

RUSSNEFT SUBS UPSIDE

Bloomberg:

VARN, ORFE,
SNFG, ORNE

Reuters:

VARN, ORFE,
SNFG, ORNE

INITIATION OF COVERAGE

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Exhibit 1

Russneft Subsidiaries: Share Ratings and Target prices

Ticker	Company name	Share Price		MCAP	Fair Value	Target Price		Upside, %		Ratings		Russneft ownership	Free float, %	USD mn
		Ord	Prefs			Ord	Prefs	Ord	Prefs	Ord	Prefs			
		USD	USD	USD mn	USD mn	USD	USD					%		
Upstream companies														
VARN	Varieganneft	26	20	654	1,141	47	30	81%	50%	Buy	Buy	38%	10%	64
SNFG	Saratovneftegas	145	112	452	384	128	81	-12%	-27%	Sell	Sell	99%	1%	5
Refineries														
ORFE	Orsk Refinery	65	55	298	611	141	90	117%	63%	Buy	Buy	96%	4%	11
Marketing														
ORNE	OrenburgNP	150	99	95	94	148	94	-1%	-4%	Hold	Hold	98%	2%	2

Source: Bloomberg, IFC Metropol estimates

*We price preference shares at 30% discount to common shares

Exposure to fastest growing oil company

Russneft is the fastest-growing oil company in Russia by production. It was founded in 2002, and has since grown by acquisition. While Russneft is not publicly traded, some of its subsidiaries are, and can provide exposure to the group's fast pace of growth for portfolio investors willing to weather the risks.

VARN: 81% upside for common shares

Varieganneft (VARN) trades at a 70% discount to peers on a reserves basis, and 10% on a production basis. We estimate Varieganneft's equity value at \$1.1 billion, suggesting upside potential of 81% from its current market value.

ORFE: 117% upside for common shares

We estimate Orsk refinery's fair equity value at \$611 million, suggesting 117% potential upside for common shares, and 63% for preference shares. Russneft is planning in 2006 to boost Orsk's throughput by 60%, to 5.5 mn tonnes, which would raise capacity utilization to 82%. While we valued ORFE on its 2005 volumes, higher 2006 production forecasts suggest potential for further increases in value.

SNFG and ORNE shares overvalued

We estimate the fair equity value of SNFG at \$384 million and ORNE at \$66 million, suggesting overvaluation of 12% and 1% respectively.

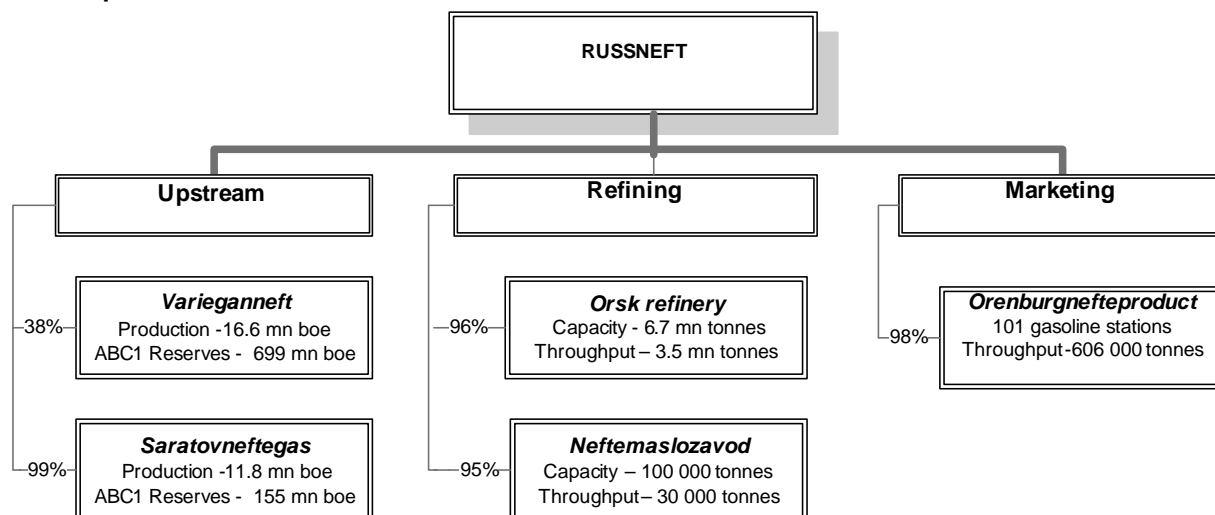
Russneft subs are speculative plays

Minority shareholders of Russneft's subsidiaries must contend with risks of poor corporate governance, including, in our view, asset and cash-flow stripping activities. Also, we think Russneft's subsidiaries lack clear exits for potential minority shareholders, such as a buy-out or consolidation. Therefore, we qualify the highlighted upsides as speculative plays that come with substantial risks.

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Russneft's public subsidiaries



Source: Company information, IFC Metropol estimates

Russneft is the youngest and fastest-growing Russian oil company, with a diversified portfolio of oil-producing assets. Russneft core shareholder and CEO, Mikhail Gutsyriev, together with Swiss international commodity trading company Glencore International, are trying to turn Russneft into an oil major via the acquisition of independent producers and non-core assets of other Russian oil companies.

Only subsidiaries' shares are traded. While Russneft shares are not traded, the group has a number of subsidiaries that are:

- Varieganneft (VARN)
- Saratovneftegas (SNFG)
- Orsk refinery (ORFE)
- Orenburgnefteproduct (ORNE)

Russneft acquired three of these public subsidiaries (SNFG, ORFE, ORNE) from TNK-BP in December 2005. SNFG is an upstream oil company with 163 million boe of proven and probable reserves, and 42,000 boe of daily production. ORFE consists of a 6.7 million tonne capacity refinery, located in the Orenburg region. ORNE is a distribution company, with 101 gasoline stations and 37 oil tank farms in the Orenburg region. Neftemaslozavod is a small specialized refinery, with 100,000 tonnes of nameplate capacity and 30,000 tonnes of lubricant production in 2005. While the acquisition price was not officially disclosed, it was rumored to be close to US\$1bn. We estimate that Russneft paid a control premium of around 40% above the TNK-BP subsidiaries' \$700mn market value, which to us seems reasonable, given the large number of bidders.

We see considerable upside potential in VARN and ORFE, while SNFG and ORNE appear overvalued. We valued Russneft's public subsidiaries using a comparison of asset-based multiples with their public peers. Based on these calculations, we believe that VARN and ORFE

shares offer sizable potential upside from their current prices. But since we see no real immediate catalyst that would trigger a price re-rating by the market, and the lack of exit options for minority investors, we think both stocks should be treated as speculative plays only.

Murky corporate governance a risk. When asked about how he would deal with minority shareholders of Russneft's subsidiaries, CEO Mikhail Gutsyriev was quoted in a Russian magazine as saying, "who said that life is fair". While he went on to say that the question of buying out minorities would depend on the price, we think the quote suitably summed up the risks of investing in Russneft's subsidiaries. These shareholders bear considerable risks of asset and cash-flow stripping, in our view.

VARN offers upside potential of 81% for common and 50% for preference shares. We estimate Varieganneft's equity value at \$1.1 billion, based on peers' asset multiples, suggesting upside potential of 81% from its current market valuation. Relative to peers, VARN trades at a discount of 70% per barrel of reserves, and at a 10% discount per barrel of production.

ORFE shares offer 117% upside for common and 63% for preference shares. We estimate Orsk's fair common equity value at \$611 million, hinting at 117% upside potential. According to statements from the company, Russneft plans to boost Orsk's throughput by 60%, to 5.5 mn tonnes, and its capacity utilization from 52% to 82% in 2006. Higher throughput suggests further upside potential for ORFE's equity value.

SaratovNG and OrenburgNP shares appear overvalued. We estimate SNFG's fair equity value at \$384 million, some 12% above its current market capitalization. ORNE is also trading at a premium to peers' asset-based multiples, suggesting downside potential of 1% from its current market valuation.

Market Valuation of Upstream subsidiaries

Subsidiary	Holding	Mcap USDmn	Net Debt* USDmn	EV USDmn	Proven Reserves mn boe	Prod-n mn boe	EV/ Reserves USD/boe	EV/ Prod-n USD/boe
MegionNG	Slavneft	7,175	209	7,384	1,755	156	4.21	47
Orenburgneft	TNK-BP	5,097	-1	5,095	1,649	121	3.09	42
Bashneft		3,230	0	3,230	1,479	90	2.18	36
Udmurtneft	TNK-BP	2,255	41	2,296	1,225	64	1.87	36
Varyeganneftegas	TNK-BP	1,255	122	1,377	1,596	33	0.86	42
Purneftegas*	Rosneft	4,982	406	5,389	5,007	90	1.08	60
Sakhalin MNG	Rosneft	1,484	131	1,615	768	23	2.10	71
Krasnodarneftegas	Rosneft	725	0.16	725	198	16	3.67	45
Stavropolneftegaz	Rosneft	193	20	213	74	8	2.89	26
Average							2.65	47
Varieganneft	Russneft	654	178	832	699	17	1.19	50
Saratovneftegas	Russneft	452	41	493	114	12	4.32	42
Average							3.07	42

Source: Company reports, Bloomberg, IFC Metropol estimates

Valuation of Russneft's upstream subsidiaries on peers' multiples

	Target EV		Target MCAP			Targeted		
	Reserves USDmn	Prod-n USDmn	Reserves USDmn	Prod-n USDmn	Mid	Upside	EV/ Reserves USD/boe	EV/ Prod-n USD/boe
Varieganneft	1,854	784	1,676	607	1,141	74%	1.89	79
Saratovneftegas	303	548	262	507	384	-15%	3.73	37

Source: Company reports, Bloomberg, IFC Metropol estimates

We valued Russneft's upstream subsidiaries using public Russian peers' asset-based multiples as a comparison. We estimate that Russian oil majors' public subsidiaries currently trade at \$2.7 per barrel of proven reserves, on average, and \$47 per boe of current production (See Exhibit 3). We used these same multiples to estimate the fair value of Russneft's public upstream subsidiaries.

VARIEGANNEFT

Varieganneft was one of Russneft's first upstream subsidiaries, and is a core asset of the group. Varieganneft is developing five oil fields - Varieganskoye, Valyunenskoye, Novo-Aganskoye, Kalinovoye and Yuzhno-Kalinovoye fields. According to Russneft's web site, Varieganneft's total recoverable reserves amount to 100 million tonnes (or some 0.7 billion boe). According to Varieganneft's 3Q05 disclosure report, its total ABC1 reserves amounted to 1 billion boe at the start of 2005, of which 67% comprised of oil and condensate liquids and 33% of gas. Applying a 30% discount to the company's ABC1 reserves, we estimate its proven reserves at 699 million boe. Varieganneft produced 1.745 million tonnes of crude oil in 2005 and 1.61 million tonnes in 2004, suggesting a YoY decline in crude oil production of 8%. Meanwhile, its gas production rose by 19%, to 0.76 bcm in 2005. Combined, the company's total production fell by only 1% in 2005.

Glencore acquired a 43.2% stake in Varieganneft in early 2005. Russneft's strategic partner, Glencore International, partly owns three of Russneft's subsidiaries - Varieganneft, Ulianovskneft and Nafta-Ulianovsk. We think that Glencore's direct equity participation reduces the swap risk for minority investors in Varieganneft.

VARN trades at discount to peers of 70% on reserves and 10% on production multiples. We estimate Varieganneft's equity value at \$1.1 billion on peers' asset multiples. This suggests 81% upside potential from its current mar-

ket valuation for common shares, and 50% for preference shares.

SARATOVNEFTEGAS

We estimate Saratovneftegas's 2P reserves at 163 million boe, and proven reserves at 114 million boe. SaratovNG reported its total ABC1 reserves at 155 million boe at the end of 2004. TNK-BP estimated its proven and probable reserves (2P reserves) at 163 million boe in 2005, when it was sold to Russneft. We applied a 30% discount to Saratovneftegas's 2P reserves and estimated its proven reserves at 114 million boe at the end of 2005.

Saratovneftegas's production fell by 26% YoY, to 12 mn boe in 2005. We believe this came as a result of a 24% decline in crude production, to 8.9 mn boe, and an almost 30% drop in gas production, to 2.9 mn boe. This decline in production can be attributed to depleted reserves and underinvestment, in our opinion. SNFG's strategy is to extend the production life of its mature fields by finding untapped reserves via exploration. Whether Russneft will be able to stabilize or even increase SNFG production still remains to be seen. Russneft's enthusiasm in purchasing this asset suggests that the company sees an opportunity to extract more value from its asset base. SNFG currently trades at a 40% premium per barrel of proven reserves relative to its peers, which seems expensive to us.

Exhibit 5

Varieganneft Reserves estimate

	Crude Oil		Condensate		Gas		Total		Share of total	
	ABC,	ABC,+C,	ABC,	ABC,+C,	ABC,	ABC,+C,	ABC,	ABC,+C,	ABC,	ABC,+C,
	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe
Varieganskoe	537	571	10	11	316	410	864	992	86%	83%
Valjuninskoe	74	105	0	0	5	8	79	112	8%	9%
Novo-Aganskoe	38	50	0	0	10	12	49	62	5%	5%
Kalinovoe	3	3	0	0	0.3	0	3	3	0%	0%
Yuzno-kalinovoe	3	28	0	0	0.3	3	4	31	0%	3%
Total	656	757	10	11	333	432	999	1200	100%	100%
Discount					30%		30%		30%	
Proven reserves estimate	459		7		233		699			

Source: Company Data, IFC Metropol estimates

Exhibit 6

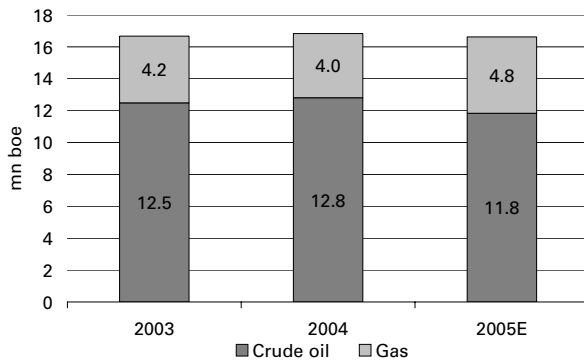
Saratovneftegas Reserves estimate, as of Jan 1, 2005

	Crude Oil		Condensate		Gas		Total	
	ABC,	ABC,+C,	ABC,	ABC,+C,	ABC,	ABC,+C,	ABC,	ABC,+C,
	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe	mn boe
Saratovneftegas	180	191	23	25	17	21	221	237
Discount	30%		30%		30%		30%	
Proven reserves estimate	126		16		12		155	

Source: Company Data, IFC Metropol estimates

Exhibit 7

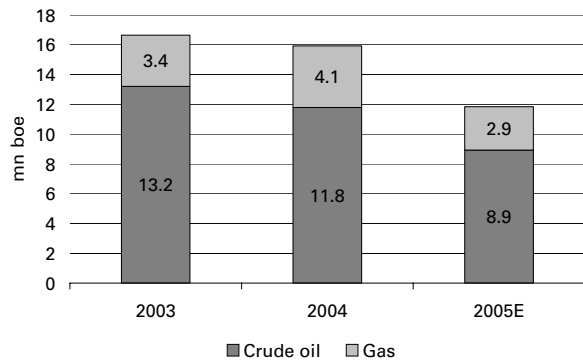
Varieganneft oil and gas production, mn boe



Source: Company reports, IFC Metropol estimates

Exhibit 8

Saratovneftegas oil and gas production, mn boe



Source: Company reports, IFC Metropol estimates

Exhibit 9

Varieganneft production results, mn boe

	2003	2004	2005E
Total oil and gas, mn boe	16.7	16.8	16.6
growth		1%	-1%
Crude oil, mn boe	12.5	12.8	11.8
growth		3%	-8%
Gas, mn boe	4.18	4.03	4.80
growth		-4%	19%

Source: InfoTEK, IFC Metropol estimates

Exhibit 10

Saratovneftegas production results, mn boe

	2003	2004	2005E
Total oil and gas, mn boe	16.6	15.9	11.8
growth		-4%	-26%
Crude oil, mn boe	13.2	11.8	8.9
growth		-11%	-24%
Gas, mn boe	3.44	4.13	2.91
growth		20%	-29%

Source: InfoTEK, IFC Metropol estimates

Russian refineries' valuation on asset-based multiples

Holding	Subsidiaries	Net debt		EV	Capacity mn tons	Thrght mn tons	EV/ Capacity	EV/ Thruput
		Mcap USDmn	USDmn				USD/ton	USD/ton
<i>Market Valuation</i>								
Bashkirsky Capital	Novo-Ufa	1,237	9	1,245	13.1	6.1	95	205
Bashkirsky Capital	Ufa Refinery	1,454	10	1,464	9.6	7.2	153	203
Bashkirsky Capital	Ufaneftekhim	1,261	-18	1,243	9.5	6.0	131	209
Rosneft	Tuapse	597	-0.5	597	3.9	4.1	153	146
Rosneft	Komsomolsk	186	-1	184	9.4	6.4	20	29
LUKoil	Norsi	1,360	156	1,516	15.0	13.4	101	113
Sibneft	Moscow	1,114	81	1,195	12.0	9.3	100	129
Slavneft	YaroslavlINOS	1,744	614	2,358	14.0	12.5	168	189
TNK-BP	Saratov	327	29	356	6.0	5.6	59	63
Average		68	2	69	19.0	13.7	4	5
Russneft	OrskNOS	298	7	304	6.7	3.5	45	86
							109	143

Source: Company reports, Bloomberg, IFC Metropol estimates

Orsk refinery's valuation on peers' asset-based multiples

	Targeted EV			Target MCAP				Targeted		Per share	
	Capacity	Thrght	Mid Case	Capacity	Thrght	Mid Case	Upside	EV/ Capacity	EV/ Thrght	ord	pref
	USD mn	USDmn	USDmn	USD mn	USDmn	USDmn	%	USD/ton	USD/ton	USD	USD
Orsknefteorgsintez	729	506	618	723	500	611	105%	109	143	588	91

Source: Company reports, Bloomberg, IFC Metropol estimates

ORSK REFINERY

TNK-BP sold Orsk refinery to Russneft at the end of 2005 for an undisclosed amount. According to TNK-BP, the refinery retained some value, but it did not fit well with TNK-BP's overall strategy. TNK-BP primarily targets the European markets, where it has identified its competitive advantage. The Orsk refinery, however, focuses on the Russian market. From TNK-BP's perspective, it made sense to sell Orsk and buy an export-oriented refinery, such as Mozheikiy Nafta. TNK-BP also saw the following drawbacks of Orsk refinery:

- **Poor geographic location and a lack of necessary logistical infrastructure.** There is no pipeline between the local oil producer, Orenburgneft, and the refinery. There is no operating synergy between the two assets as a result. Orenburgneft also produces light crude, which is mostly exported. Meanwhile, Orsk refinery receives crude from Kazakhstan. Therefore, the operator of the Orsk refinery needs to constantly enter into crude swap agreements with Kazmunaigas, the Kazakh state energy company, which saps management's time.
- **Local markets have been deemed unattractive by TNK-BP.** Product export is not very profitable from the Orsk refinery, due to its remote location. At the same time, local markets are very competitive and not very attractive, in TNK-BP's view.
- **Sub optimal structure of refining assets** that resulted in low capacity utilization (only 52% in 2005).

- **The Orsk refinery requires an extensive modernization programme to replace depreciated assets.** TNK-BP decided this was unfeasible. Modernization required large capital outlays that would yield poor return on capital. Without modernization, the refinery could lose its domestic market share over time.

Russneft plans to boost Orsk's throughput by 57%, to 5.5 million tonnes in 2006. Russneft has ambitious plans for its newly acquired Orsk refinery. The company has stated that it wants to boost the refinery's throughput by 60%, to 5.5 million tonnes in 2006. The planned increase would improve its capacity utilization rate from 52% in 2005, to 82% in 2006.

We estimate the Orsk refinery's fair equity value at \$611 million, suggesting more than 117% upside for its common and close to 63% for preference shares. We valued the refinery using comparisons with its peers' asset-based multiples. We estimate that the refining subsidiaries of Russian oil majors are currently trading at \$109 per tonne of capacity, and around \$143 per tonne of throughput (see Exhibit 11). We applied those multiples to the Orsk refinery's 2005 indicators. Based on these calculations, we estimated the refinery's equity value at around \$611 million, which suggests upside potential of some 117% for common shares, and 63% for preference shares. It should be noted that we consider this to be a conservative valuation. If Russneft were to invest a large amount of capital to upgrade the facility or substantially increase its load factor, the refinery's financial performance and equity valuation could improve substantially, in our view.

Relative valuation of Russian marketing subsidiaries on asset-based multiples

Ticker	Company name	Mcap	Net debt	EV	# gas stations	Thrhgpt	EV/# gas stations	EV/Thrhgpt
		USDmn	USDmn	USDmn	units	000 tons	USDmn/ unit	USD/ton
TNK-BP Subs (Consolidation)								
RYAZ	RyazanNP	64	2.7	67	86	388	0.775	172
TUNP	TulaNP	5	3.3	8	56	30	0.146	272
KALG	KalugaNP	12	1.4	13	49	44	0.263	293
SARN	SaratovNP	69	-3.1	66	102	290	0.644	226
RNPR	RostovNP	6	2.4	8	38	108	0.210	74
ORNE	OrenburgNP	74	2	76	102	200	0.744	379
Average							0.673	231
Public Marketing Companies								
ALNP	AltaiNP	35	2.5	37	107	325	0.348	115
RNCU	KurganNP	20	1.4	22	49	91	0.440	236
SMNF	SmolenskNP	32	-0.6	32	84	419	0.379	76
KUNP	KubanNP	86	12.5	99	164	546	0.603	181
MYNT	MurmanskNP	20		22	36	79	0.598	273
UDNP	UdmurtNP	31	49	81	112	630	0.720	128
Average							0.533	162
ORNE	OrenburgNP	95	10	105	101	606	1.044	174
<i>Premium to TNK-BP Subs</i>							55%	-25%
<i>Premium to traded public peers</i>							149%	96%

Source: Company reports, IFC Metropol estimates

Exhibit 14

OrenburgNP valuation on peer asset-based multiples

		Target EV			Target MCAP			Targeted		
		gasoline stations	Thrhgpt	Mid Case	gasoline stations	Thrhgpt	Mid Case	Upside	EV/ station	EV/ Thrhgpt
		USD mn	USDmn	USDmn	USD mn	USD mn	USD mn	%	USDmn	USD/ton
ORNE	OrenburgNP	68	140	104	58	130	94	-2%	1.03	172

Source: Company reports, IFC Metropol estimates

ORENBURG NP VALUATION

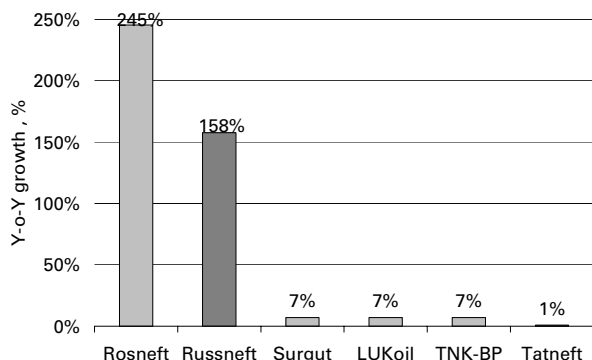
Orenburgnefteproduct (ORNE) was acquired by Russneft from TNK-BP at the end of 2005, along with its Orsk refinery and some other assets. We believe that it made perfect strategic sense to sell from TNK-BP's point of view, and to buy from Russneft's. The deal gave Russneft a local distribution company, along with a refinery. OrenburgNP has 101 filling stations and 37 oil tank farms. OrenburgNP sold 303,000 tonnes of oil products in 1H05, according to its disclosure reports. Annualising 1H throughput, we estimate ORNE sale volumes at 606,000 tonnes in 2005.

OrenburgNP's equity was valued at \$74 million by Deloitte in early 2005. Deloitte's 2005 valuation of TNK-BP's marketing subsidiaries produced an average value of \$231 per tonne of throughput, and \$0.673 mn per gasoline station owned by those distribution companies (Exhibit 13). Since Deloitte's valuation in early 2005, OrenburgNP has sold one gas station and increased its net debt position from \$2 million to \$10 million, while its market capitalisation soared by 46%, from \$54 million to \$95 million.

OrenburgNP shares appear overvalued, trading at a premium to peers' average asset-based multiples. We valued ORNE using both asset-based multiples derived from Deloitte's earlier valuation of TNK-BP's marketing subsidiaries, and from current market valuations of public peers. Applying these metrics to ORNE, we estimate its equity value at \$94 million on TNK-BP multiples, suggesting some 1% downside from its current market capitalisation. If we use asset multiples of the traded Rosneft marketing subsidiaries, it would result in an even lower ORNE equity estimate of some \$57 million, suggesting downside potential of 47% from its current market value. We based our target valuation of OrenburgNP on TNK-BP multiples, suggesting an equity

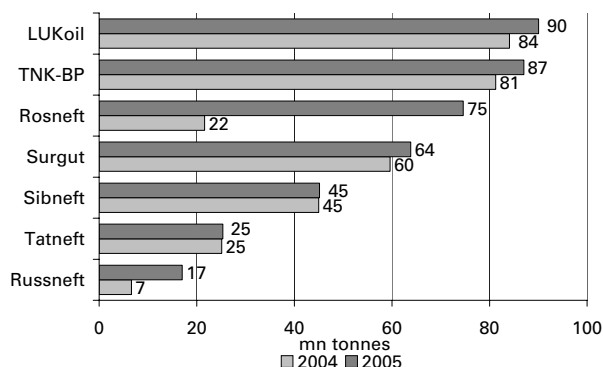
value of \$94 million, and a fair value of \$148 per common share and \$94 per preference share.

Exhibit 15

Russian oil companies: production growth in 2005, %

Source: InfoTEK, IFC Metropal estimates

Exhibit 16

Russian oil companies: oil production in 2004-05, mn tonnes

Source: InfoTEK, IFC Metropal estimates

RUSSNEFT OVERVIEW

Russneft is the youngest and fastest growing vertically integrated Russian oil company, and is one of the ten major oil companies in the country. Established in September 2002, Russneft's structure currently includes around 30 upstream oil producing companies, 3 refining and 2 transportation subsidiaries, as well as a modern network of 300 retail service stations, which are located in 17 regions of Russia and the CIS. Russneft's network covers Western Siberia, Tomsk, Novosibirsk, Ulyanovsk, Penza, Samara, Bryansk, Leningrad, Saratov and Orenburg oblast, the Krasnodar Region, and the republics of Udmurtiya, Komi and Belarus. Its head office is located in Moscow. Russneft is currently developing more than 100 oil fields, with total recoverable reserves in excess of 630 million tonnes (4.6 billion boe). Annual production reached 17 million tonnes (125 million boe) in 2005. Russneft has also launched its own oil loading terminal in the Bryansk region, with capacity of 5-7 million tonnes of crude oil per year.

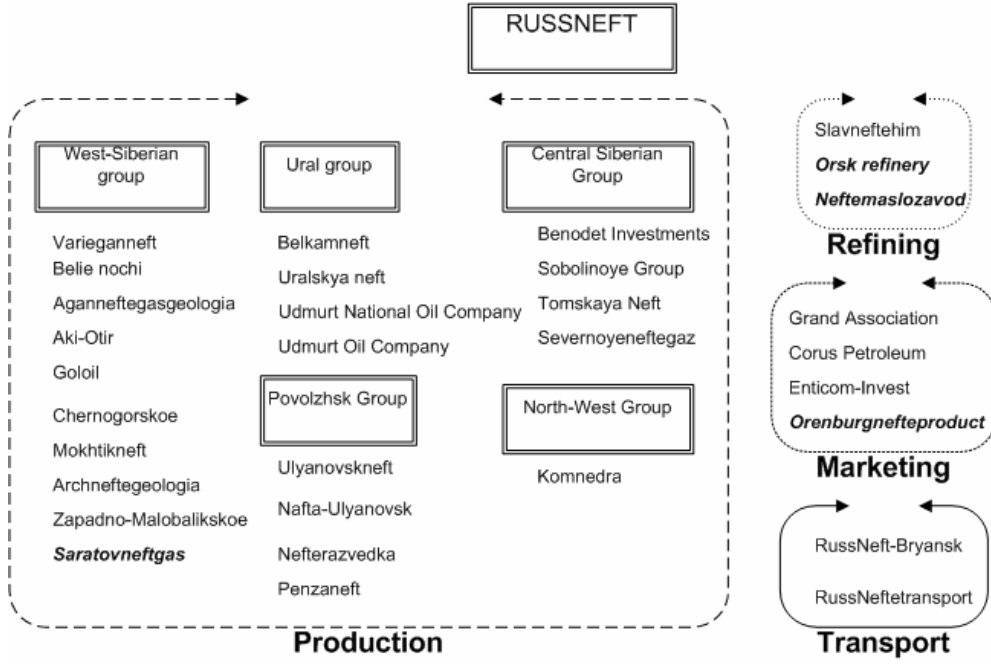
Since its inception in 2002, Russneft has proved to be an active and aggressive player in the Russian energy sector. In such a short time period, it has managed to consolidate practically all the independent oil producing assets available. During 2002 and 2003, Russneft consolidated its business, acquiring promising oil producing assets. During the second stage, in 2004, Russneft integrated its own and newly acquired subsidiaries into a unified production network. At the same time, the company increased its resources by acquiring new assets. Russneft targeted small and medium-sized producers, including those facing charges on violation of license agreements. In 2004, Russneft was able to increase its crude oil production fivefold, bringing it to 10 million tonnes. It took its place among the ten leading oil companies of Russia. In 2005, it bought seven small oil producers, and increased its annual oil output from 10 to 17 million tonnes. Specifically, in 2005 Russneft bought Agan-

neftegeologia, Yukos' share of a joint venture with Hungarian MOL Zapadno-Malobalykskoye, Tomskaya Neft, UNNK, and Saratovneftegas. In 2005, the company reached its main goal of becoming vertically integrated, acquiring three oil refineries and nearly 300 gasoline stations. In 2005, Russneft bought three oil refineries, increased its resources by 70%, commissioned the oil loading terminal in the Bryansk region, became a leader at the fuel market of Moscow and its province, and successfully placed its debut ruble bond issue.

Russneft is planning to boost production to 20-25 million tonnes in 2006. According to the company, Russneft is planning to continue acquiring new assets in line with its strategic priorities, while raising its crude oil production to 20-25 million tonnes per annum. It is planning to buy TNK-BP's upstream subsidiary, Udmurtneft, and receive some of LUKoil's assets in exchange for Russneft's 34% stake in Geoilbent. Russneft's long-term goals include becoming a leading producer of crude oil, gas and gasoline products, with production topping 100 million tonnes per year, expanding the geography of its activities to include the Middle East and the CIS, and entering world capital markets.

Glencore is Russneft's strategic partner in Russia. Glencore currently holds 49% of Russneft's shares as security against unspecified loans it has provided to the company. Glencore, the largest non-integrated oil supplier by volume, has also signed an agreement with Russneft to act as its exclusive off-taker for the next ten years. Glencore distributes some 3% of the world's daily oil consumption of crude oil and refined products. We believe that it is financing Russneft's aggressive growth in order to eventually exit via an IPO or trade sale.

Russneft structure: main business



Source: Company data

Russneft: Geography of activities



Source: Company data, February 2006

VARN

BUY

Price:\$26
Target price: \$47

Varieganneft is 25 years old. The oil field from which it takes its name was discovered and developed much earlier.

JSC Varieganneft today is a large company producing oil and gas. It holds several licenses to explore and develop four oil fields – Varieganskoe, Novo-Aganskoe, Kalinovskoe, and Valyunenskoe. The company's first priority is to slow down the decline in oil yields, and to stabilise oil output by using new techniques, including fluid fracturing of oil beds, to boost oil recovery.

Geological prospecting continues to increase hydrocarbon reserves.

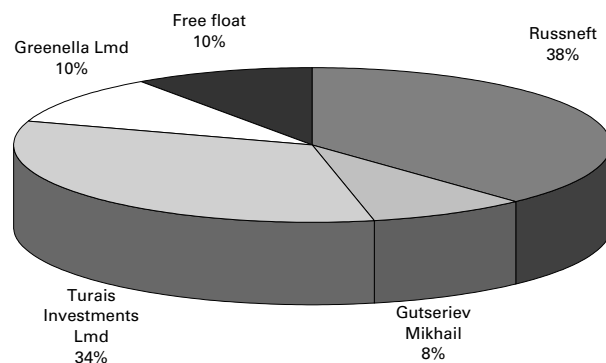
Varieganneft is developing projects aimed at attracting investments for continued modernization of the company's core operations, and tapping new hydrocarbon resources. An automated data gathering system would help to control oil production and save considerable resources.

Varieganneft: financial summary, 2004-2005E

	2004	2005E
Accounting standard	RAS	RAS
Key Assumptions		
RUR/USD, end of period	27.7	28.8
RUR/USD, average	28.8	28.3
Income Statement		
Revenues	151	200
COGS	149	188
Operating profit	1	11
Net income	-9	-12
Balance Sheet		
Cash	6	1
Receivables	57	39
Inventory	21	19
Other Current assets	0	25
Fixed assets	87	90
Other non-current assets	0	0
Total Assets	361	302
Accounts payable	18	24
Short-term debt	47	32
Long-term debt	184	146
Shareholders' equity	106	316
Total Liabilities & Equity	361	302
Total Debt	231	178
Net Debt	226	177
Credit		
Net debt to equity, %	213.24	56.10
Total debt to total capital, %	218.57	56.31
Profitability (%)		
Operating margin	0.84	5.51
Net margin	-6.21	-6.24
Growth (%)		
Revenues	na	32.02
Operating profit	na	766
Net income	na	33
Return		
ROE, %	-8.89	-3.94

Source: company data

Varieganneft: shareholders' structure



Source: company data

Varieganneft: valuation ratios

	2004	2005E
Valuation ratios		
P/E	neg	neg
P/Book	6.18	2.07
EV/Sales	5.81	4.16
Key drivers		
Revenue growth	na	32.02
Operating margin	0.84	5.51
Net margin	neg	neg

Source: company data

Varieganneft: company data

Address	36, ul. Lomonosova, Raduzhnyi, 626448
Tel/fax	(34668) 41-639/41-606
General Director	Gutseriev Mikhail
e-mail	ak_vn@mail.ru
web site	www.oaovn.ru
Auditors	na

Source: company data

SNFG

SELL

Price: \$145
Target price: \$128

Saratovneftegas is based in the Saratov region, and accounts for 90% of local hydrocarbon feed production. The company develops the fields in the Saratov and Volgograd regions.

As of the 1st of January, 2006, Saratovneftegas was developing 35 fields, of which 32 were under commercial production and 3 under production testing. The biggest oil and gas condensate fields are Alexeyevskoe, Vasetsovskoye, Gorchakovskoye and Mechetkinskoye.

The key element of Saratovneftegas' policy is prolonging the production periods of its mature fields, through opening new reserves and moving them into the production process.

Incremental ultimate recovery is mostly obtained through running geological and engineering operations. In 2005, Saratovneftegas completed more than 20 investment projects aimed at maintaining the basic volumes of crude oil production and ensuring its growth.

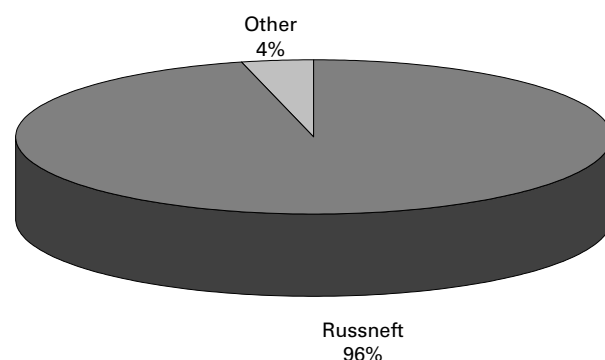
In 2006, Saratovneftegas plans to continue its exploration and geological engineering operations.

Saratovneftegas: financial summary, 2003-2005E

	2003	2004	2005E
Accounting standard	RAS	RAS	RAS
Key Assumptions			
RUR/USD, end of period	31.8	27.7	28.8
RUR/USD, average	30.7	28.8	28.3
Income Statement			
Revenues	111	150	254
COGS	105	121	207
Operating profit	5	18	35
EBITDA	25	41	55
Net income	-15	4	59
Balance Sheet			
Cash	0	6	1
Receivables	101	113	232
Inventory	10	12	10
Other Current assets	0	0	0
Fixed assets	175	201	171
Other non-current assets	0	0	0
Total Assets	345	380	461
Accounts payable	21	45	89
Short-term debt	34	40	42
Long-term debt	0	0	0
Shareholders' equity	269	286	316
Total Liabilities & Equity			
Total Debt	34	40	42
Net Debt	34	34	41
Credit			
Net debt to equity, %	12.62	11.79	12.98
Total debt to total capital, %	12.64	14.01	13.19
Profitability (%)			
Operating margin	4.22	12.28	13.88
Net margin	-13.53	2.53	23.26
Growth (%)			
Revenues	na	35.65	69.08
Operating profit	na	295	91
Net income	na	-125	1457
EBITDA	na	67	33
Return			
ROE, %	-5.56	1.33	18.70

Source: company data

Saratovneftegas: shareholders' structure



Source: company data

Saratovneftegas: valuation ratios

	2003	2004	2005E
Valuation ratios			
P/E	neg	118.96	7.64
P/Book	1.68	1.58	1.43
EV/Sales	4.38	3.23	1.94
EV/EBITDA	19.82	11.83	9.04
Key drivers			
Revenue growth	na	35.65	69.08
Operating margin	4.22	12.28	13.88
EBITDA margin	22.12	27.31	21.46
Net margin	neg	2.53	23.26

Source: company data

Saratovneftegas: company data

Address	21, ul. Sakko i Vantsetti, Saratov, 410600
Tel/fax	(8452) 48-97-74/48-97-74
General Director	Bishov Sergei
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web site	www.sng.ru
Auditors	na

Source: company data

ORFE

BUY

Price:\$65
Target price: \$141

Orsknefteorgsintez is one of the leading refineries in Russia.
Its crude oil refining capacity in 2005 was 6.6 mn tonnes.

The Orsk refinery produces gasoline, diesel, aircraft gasoline, bitumen, black oil and other refinery products.

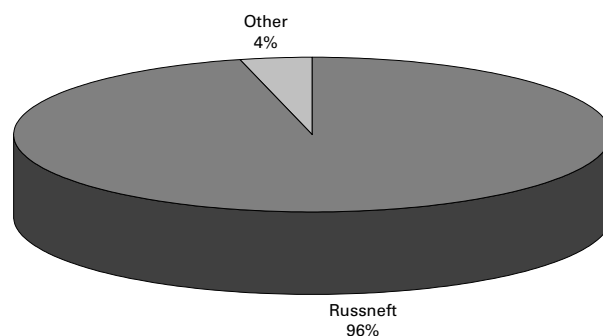
In 2005, the Orsk refinery's throughput was 3,589.56 thousand tonnes of crude oil. ORFE produces 543.4 thousand tonnes of gasoline, 1,010.9 thousand tonnes of diesel, which comes to 130% of volumes in 2004.

Orsk refinery: financial summary, 2003-2005E

Accounting standard	2003	2004	2005E
	RAS	RAS	RAS
Key Assumptions			
RUR/USD, end of period	31.8	27.7	28.8
RUR/USD, average	30.7	28.8	28.3
Income Statement			
Revenues	185	65	79
COGS	160	43	44
Operating profit	1	2	8
EBITDA	5	7	13
Net income	-1	1	3
Balance Sheet			
Cash	0.2	0.5	0.5
Receivables	41	23	24
Inventory	10	6	6
Other Current assets	0.0	0.0	0.0
Fixed assets	45.0	49.8	47.5
Total Assets	113.8	93.4	94.2
Accounts payable	64.8	38.6	37.2
Short-term debt	2.0	2.4	2.4
Long-term debt	5.7	7.6	7.6
Shareholders' equity	41	43	45
Total Liabilities & Equity	114	93	94
Total Debt	7.8	10.0	10.0
Net Debt	7.6	9.5	9.5
Credit			
Net debt to equity, %	18.65	21.91	21.29
Total debt to total capital, %	19.03	23.11	22.40
Profitability (%)			
Operating margin	0.54	2.51	9.81
Net margin	-0.27	1.00	4.41
Growth (%)			
Revenues	na	-64.97	22.10
Operating profit	na	62	376
Net income	na	-228	440
EBITDA	na	38	90
Return			
ROE, %	-1.23	1.49	7.80

Source: company data

Orsk refinery: shareholders' structure



Source: company data

Orsk refinery: valuation ratios

	2003	2004	2005E
Valuation ratios			
P/E	neg	461	85
P/Book	7.30	6.89	6.67
EV/Sales	1.65	4.75	3.89
Key drivers			
Revenue growth	na	neg	22.10
Operating margin	0.54	2.51	9.81
EBITDA margin	2.58	10.18	15.82
Net margin	neg	1.00	4.41

Source: company data

Orsk refinery: company data

Address	1a, ul. Goncharova, Orsk, Orenburgskaya obl.,
Tel/fax	(3537) 25-42-02/25-06-28
General Director	Vladimir Pilugin
e-mail	mail@onos.orgus.ru
web site	www.ornpz.ru
Auditors	na

Source: company data

ORNE

SELL

Price: \$150

Target price: \$104

Orenburgnefteproduct is a big fuel and lubricant supplier in the Orenburg region. The company incorporates more than 100 retail outlets catering to the entire Orenburg region. The mobile laboratory allowing the quality of the products sold from the company's gas-filling stations to be tested is one of its competitive advantages.

Orenburgnefteproduct's gasoline stations make up 38% of the retail market of the Orenburg region. At the same time, petroleum products retail sales via its gas-filling stations account for more than 50% of the market.

The company's network of tank farms spread over the territory of the region supplies fuel to wholesale customers, including local farmers, municipal services and budgetary institutions of the Orenburg region.

In 2006, Orenburgnefteproduct plans to update some of its key retail outlets to offer improved and full-range services to its clients.

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INITIATION OF COVERAGE

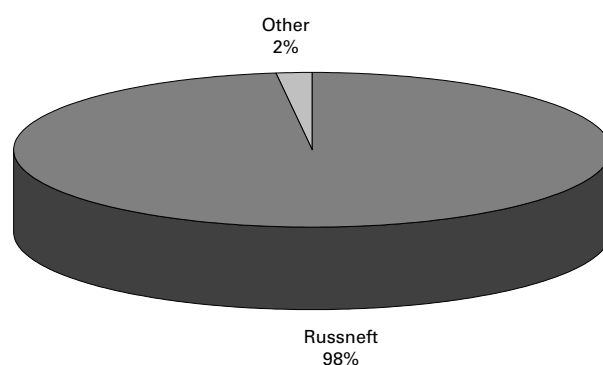
RUSSNEFT SUBS

Orenburgnefteproduct: financial summary, 2003-2005E

	2003	2004	2005E
Accounting standard	RAS	RAS	RAS
Key Assumptions			
RUR/USD, end of period	31.8	27.7	28.8
RUR/USD, average	30.7	28.8	28.3
Income Statement			
Revenues	130	174	244
COGS	95	134	179
Operating profit	0	1	13
EBITDA	1	2	14
Net income	-0.05	0.31	9
Balance Sheet			
Cash	2.04	1.70	5
Receivables	5.59	6.32	10
Inventory	5.50	10.08	6
Other Current assets	0.13	0.00	1
Fixed assets	10.09	10.05	9
Total Assets	26	30	34
Accounts payable	12.3	15.6	10.9
Short-term debt	0.0	0.1	0.1
Long-term debt	3.1	3.1	3.0
Shareholders' equity	10	11	18
Total Liabilities & Equity	26	30	34
Total Debt	3.1	3.2	3.1
Net Debt	1.0	1.5	-1.7
Credit			
Net debt to equity, %	10.00	14.01	-9.22
Total debt to total capital, %	30.14	29.62	17.02
Profitability (%)			
Operating margin	0.07	0.54	5.19
Net margin	-0.04	0.18	3.51
Growth (%)			
Revenues	na	33.30	40.51
Operating profit	na	882	1241
Net income	na	-741	2633
EBITDA	na	169	508
Return			
ROE, %	-0.48	2.89	46.55

Source: company data

Orenburgnefteproduct: shareholders' structure



Source: company data

Orenburgnefteproduct: valuation ratios

	2003	2004	2005E
Valuation ratios			
P/E	neg	304	11
P/Book	9.41	8.78	5.18
EV/Sales	0.74	0.56	0.38
EV/EBITDA	113.75	42.54	6.76
Key drivers			
Revenue growth	na	33.30	40.51
Operating margin	0.07	0.54	5.19
Net margin	neg	0.18	3.51
EBITDA margin	0.65	1.31	5.68

Source: company data

Orenburgnefteproduct: company data

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Auditors	na

Source: company data



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