



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 25, 2006

Salavatnefteorgsintez

COMPANY
NOTE

BUY

UPSIDE: 68 %

Target Price: US\$112

Independent Star

Analyst:

Nikolay Saperov

saperovn@sovlink.ru

STOCK DATA

Ticker	snoz	MCap (\$ mn)	1,172
Shares Ords	18,550,851	Free Float, %	20
Shares Pref	-	Free Float (\$ mn)	234
Bid Ords (\$)	63.2	Offer Ords (\$)	66.5
Bid Prefs (\$)	-	Offer Prefs (\$)	-

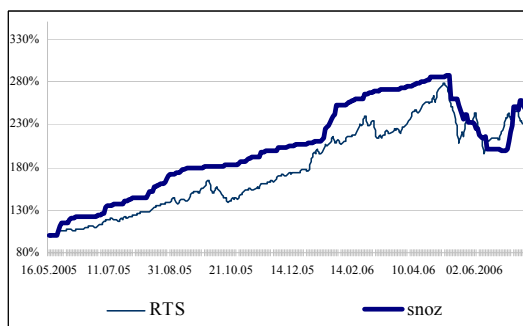
MARKET PERFORMANCE

		1 month	6 months
Absolute	Ords	23%	10%
	Prefs	-	-
Relative to RTSI	Ords	11%	-5%
	Prefs	-	-
Price range (US\$)			
	High	Ords	69.5
	Low	Ords	54.0
	High	Prefs	-
Low	Prefs	-	-

PERFORMANCE 2005

Revenue (\$ mn)	2,260	EBITDA(\$ mn)	144
P/BV	2.48	EV/S	0.77
Net Income (\$ mn)	16	P/S	0.46

SNOZ RELATIVE PERFORMANCE



Source: RTS, Sovlink Securities

- The Russian oil refining and petrochemical industries are changing substantially, as companies begin to realize the need for huge investments. Products of deeper refining are more expensive than crude oil and natural gas, and the prices of petrochemical products are more stable—they do not have as much volatility as the oil market.

- Salavatnefteorgsintez is one of the largest petrochemical plant and oil refineries in the Bashkortostan Republic and in Russia. The company produces over 140 different kinds of products, and has more than a 50% share of the butyl alcohol market and about 40% of the plasticizer market. Salavatnefteorgsintez unifies seven plants with aggregate annual capacity of 12 mn tons.

- Salavatnefteorgsintez has long-term investment programs to modernize its production facilities. The implementation of large investment programs is considered to be a priority in the company's development. Investments in production facilities and manufacturing diversification will undoubtedly result in increases in the company's financial results. The company plans to increase revenues 50% in 2006.

- Currently, the controlling stake in Salavatnefteorgsintez is managed by Gazprom. Collaboration with the gas monopoly provides Salavatnefteorgsintez with support in raw materials supply. The question of raw materials provision is very important for Salavatnefteorgsintez, because the plant currently has excess capacity.

- A comparison with the company's Russian and foreign peers (oil refiners and petrochemical companies) suggests an undervaluation of the company on P/S, P/BV and P/PPE* multiples.

- Our valuation suggests a fair market capitalization of \$1,968 mn or \$112 per share. This implies 68% upside. We rate the stock a **Buy**.

* P/PPE—Price to Personal Protective Equipment

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

research@sovlink.ru



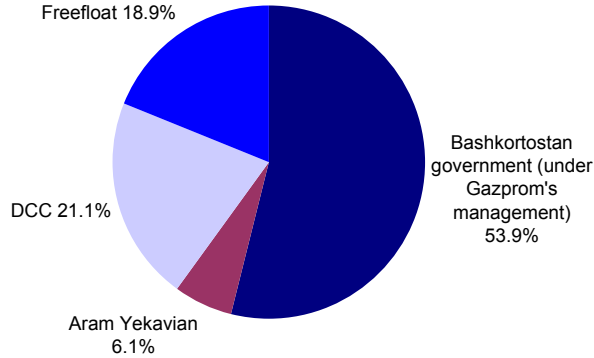


The Russian petrochemical industry

- Throughout the world, the largest oil holdings are focusing on enlarging the portion of oil and gas refining in their businesses. On the one hand, companies diversify their businesses in this way. On the other hand, they enlarge the share of high value-added production. The Russian oil refining and petrochemical industries stand on the brink of significant changes, as Russian oil and gas companies are realizing the importance of these global trends. Products of deep processing are more expensive than crude oil and natural gas, their prices are more sustainable and do not have the high level of volatility that oil prices do. Lukoil, Gazprom and Surgutneftegaz have significant investment programs for oil refining and petrochemistry. In May, President Vladimir Putin proclaimed the necessity of developing the oil refining industries with high value-added products, blaming Russian companies for paying insufficient attention to this sector. We assume that the trend of enlarging the petrochemical sector in oil companies' overall output will continue.
- According to recent Gazprom announcements, the company is increasing its activity in petrochemistry. The company is building a polyethylene refinery in Noviy Urengoy and has announced plans to build a methanol plant in Arkhangelsk. Taking this into account, the delivery of the Bashkortostan government's controlling stake in Salavatnefteorgsintez to Gazprom—which already manages the stake—seems to be feasible.
- We believe that the oil refining and petrochemical industries are potentially much more attractive than oil and gas production primarily because of huge investment possibilities. This attractiveness is upheld by a lack of secondary processing facilities and by governmental support for industry development. Further, the long amount of time that is needed for modernization facilities and putting new facilities into operation should support the high prices for refined oil products on the domestic market. The increase of investment in petrochemical and refining capacity creates a background for market capitalization growth.
- The largest oil and gas companies regard the development of their petrochemical and refining businesses as priorities. They intend to wager on high-capacity plants that have favorable geographical locations and significant modernization plans, especially as this is supported by the government.
- The chemical industry produces 6% of Russia's total industrial output (in fifth place after the fuel, energy, metallurgy and machine-building industries). Further, it has the same share of Russian exports. In the future, we expect an increase in the chemical industry's share of GDP, due to significant investment inflows in this sector. Finally, the diversification of production and deepening of oil refining are drivers for market capitalization growth at petrochemical companies.



Shareholder structure



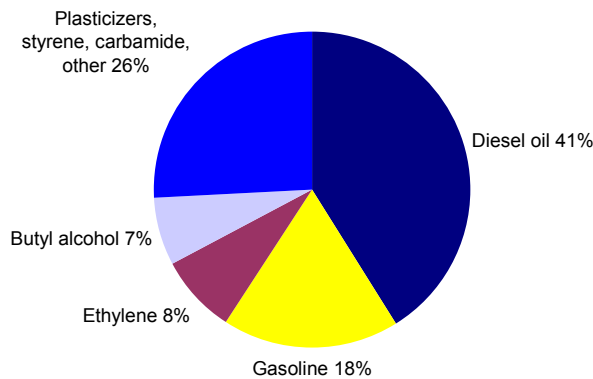
Source: Company data, Sovlink Securities

- The controlling stake in Salavatnefteorgsintez is currently managed by Gazprom. The gas monopoly's participation in managing Salavatnefteorgsintez guarantees support in raw material supply, which is very important for Salavatnefteorgsintez due to the company's current excess capacity. The company is almost completely dependent on Gazprom's raw material supply, which we believe suggests the possibility of the controlling stake ultimately being transferred to Gazprom.

Company description

- Salavatnefteorgsintez is one of the largest petrochemical and petroleum-refining complexes in the Republic of Bashkortostan and Russia. The company produces over 140 different products, of which the most important are diesel fuel, auto petroleum, butyl alcohol, plasticizers and ethylene.

Revenue structure



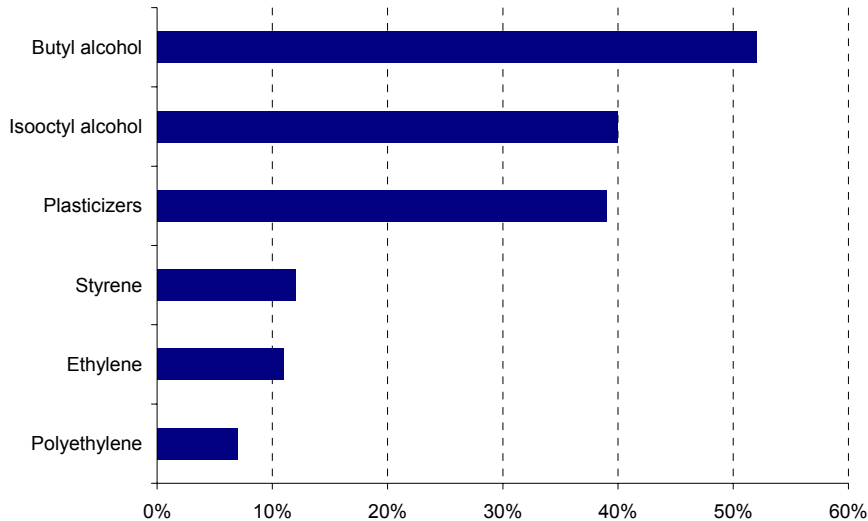
Source: Company data, Sovlink Securities





- Salavatnefteorgsintez occupies a significant portion of the petrochemical industry of Russia. The company controls over half of the butyl alcohol market and about 40% of the plasticizer market.

Salavatnefteorgsintez' share in Russian petrochemical production



Source: Company data, Sovlink Securities

- Salavatnefteorgsintez controls seven plants with total output of 12 mn tons per year. The company's main business units are an oil refinery, a petrochemical plant, its Synthes plant, its Manomer plant, a fertilizer plant, a catalyst plant and 20 petrol stations in the region.
- Salavatnefteorgsintez is unique among Russian companies in that it combines oil refining and petrochemical complexes, which allows the company to obtain more independence from market volatility.
- The company's capacities allow it to refine both oil and gas condensate, which is unique to Salavatnefteorgsintez. The company's technological chain is vertically integrated—all of its industrial processes are situated in one area, which allows the company to control expenses.
- Salavatnefteorgsintez leads the Russian petrochemical industry by refining depth. In 2005, the company posted a 78.1 % refining depth, while the industry average was 72%.
- The company's main development plan is an investment program which envisages building new and modernizing operating production capacity on the basis of modern ecological techniques.
- Salavatnefteorgsintez has embarked on the strategic course of increasing the refining depth of oil and other carbohydrates to avoid the problem of a raw material shortage in Russia.



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- Salavatnefteorgsintez has constantly supported long-term capacity modernization programs. The realization of large investment programs is the company's development priority. To this extent, a bitumen production line was started in 2005, and the company expects to complete the construction of a viscosity breaking plant this year. The total investment level for these long-term projects in 2006 is \$180 mn, including \$85 mn for the construction of new plants. The company's main investment plans are the construction of a new polyethylene production plant, which will be able to produce up to 120,000 tons of polyethylene a year, the construction of a viscosity breaking production line and a catalytic cracking plant, the modernization of its petroleum-refining and chemical fertilizer production lines, and the reconstruction of a pyrolysis oven.
- Salavatnefteorgsintez' investment attraction is underlined by the fact that the company is not associated with the Bashkirian Capital holding, and therefore lacks a number of political risks.

Financials, \$ mn

	2004	2005	2006E
Revenues	1,266	2,260	3,396
EBITDA	109	144	340
Net profit	53	16	170
EBITDA margin, %	9%	6%	10%
Net margin, %	4%	1%	5%

Source: Company data, Sovlink Securities

- The company's revenues rose 78% in 2005, while net profit significantly dropped. The increase in revenues was due to a rise in petrochemical and refined product prices, which follow oil price dynamics with a time lag. The company's low net profit in 2005 looks particularly odd, considering that most of its peers are able to post a net margin of 7% or higher. As such, we believe that the company's 2005 net profit may have been artificially distorted to show such a low number, and expect the company to achieve normal profitability in 2006—a 5% net margin and a 10% EBITDA margin.

Multiples

	2005	2006E
P/S	0.46	0.31
EV/S	0.77	0.51
P/BV	2.48	2.48
EV/EBITDA	12.10	5.14
P/E	65.38	6.16

Source: Sovlink Securities



Valuation

Russian peer comparison. 2005

Company	Ticker	M.Cap, \$ mn	Revenues, \$ mn	BV, \$ mn	PPE, \$ mn	P/S	P/BV	P/PPE	P/E
Ufaeftekhim	UFNC	853	503	566	118	1.70	1.51	7.23	4.18
Novoil	nunz	1,024	453	361	105	2.26	2.84	9.75	9.23
Ufa Refinery	unpz	981	486	451	104	2.02	2.18	9.43	32.70
Ufaorgsintez	ufos	327	247	184	67	1.32	1.78	4.88	8.18
Yaroslavnefteorgsintez	JNOS	1,025	226	438	712	4.54	2.34	1.44	34.17
Kazanorgsintez	KZOS	741	474	454	166	1.56	1.63	4.46	10.44
Average						2.23	2.04	6.20	16.48
Salavatnefteorgsintez	snoz	1,172	2,260	422	359	0.46	2.48	2.91	65.38
Upside						382%	-18%	113%	-75%
Weight						20%	20%	40%	20%
Weighted upside									103%

Source: Skrin.ru, Company data, Sovlink Securities

• Salavatnefteorgsintez looks undervalued in comparison to its Russian peers on most multiples. At the same time, its P/PPE ratio—market capitalization to fixed assets—is noticeably lower than the industry average. Taking into consideration that the company is implementing large investment programs geared towards its production facilities and fixed asset modernization over the several years, we feel Salavatnefteorgsintez should have a P/PPE no less than the industry average. We feel that noticeable market capitalization growth potential is underlined by the company's P/S ratio, which is significantly lower than the industry average. Salavatnefteorgsintez looks overvalued on a P/E basis, but this is due to its extremely low reported net profit for 2005 (by Russian Accounting Standards), which we consider to be artificially distorted. We forecast net profit of \$170 mn in 2006, which corresponds to a 5% margin (which is still lower than the industry average of 10%). In this case, Salavatnefteorgsintez would be trading on a P/E of 6.16.

Foreign peer comparison

Emerging market peer comparison

Company	Country	P/S	P/BV	EV/EBITDA
Reliance Industries Limited	India	2.25	3.53	7.06
Formosa Petrochemical Corp	Taiwan	1.25	2.71	8.94
S-Oil Corporation	South Korea	0.67	3.18	5.37
PKN	Poland	0.58	1.24	5.95
Tupras	Turkey	0.38	1.74	5.52
Pakistan State Oil Co.	Pakistan	0.24	2.95	6.76
Shell Refining Co.	Malaysia	0.33	1.67	3.38
Qatar Fuel Co.	Qatar	1.26	3.42	13.68
Hankook Shell Oil Co.	South Korea	0.90	1.62	5.99
Average		0.87	2.45	6.96
Salavatnefteorgsintez	Russia	0.46	2.48	12.1
Upside		90%	-1%	-42%
Weight		40%	40%	20%
Weighted upside				27%

Source: Bloomberg, Sovlink Securities



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Developed market peer comparison

Company	Country	P/S	P/BV	EV/EBITDA
Frontier Oil	US	0.96	8.58	1.78
Holly Corp	US	0.86	5.15	5.29
Alon USA Energy	US	0.68	5.49	4.31
Fuchas Petrolub	Germany	0.79	4.27	5.97
Toa Oil Co	Japan	0.92	1.81	9.93
Fuji Kosan Company	Japan	0.27	4.57	25.20
Arabian-American Development	US	0.49	1.07	4.41
Valero Energy	US	0.51	2.74	5.82
Average		0.68	4.21	7.84
Salavatnefteorgsintez	Russia	0.46	2.48	12.1
Upside		49%	70%	-35%
Weight		40%	40%	20%
Weighted upside				40%

Source: Bloomberg, Sovlink Securities

- Salavatnefteorgsintez looks undervalued relative to its foreign peers, both in emerging and developed markets. Our weighted upside estimate is 40% versus emerging market peers, and 27% versus developed market peers.

Weighted valuation estimate

	Upside	Weight
Russian peers	103%	50%
Emerging market peers	27%	30%
Developed market peers	40%	20%
Weighted upside	68%	
Target price, \$	112	

Source: Sovlink Securities

- Our weighted valuation estimates suggests a fair value of Salavatnefteorgsintez of \$1,968 mn, or \$112 per share. This implies upside of 68%, thus we rate the stock a **Buy**.





STOCK RATING POLICY

STRONG BUY:	Target price offers upside of over 100%; confidence level – high
STRONG BUY (SPEC):	Target price offers upside of over 100%; confidence level – low
BUY:	Target price offers upside of between 25% and 100%; confidence level – high
BUY (SPEC):	Target price offers upside of between 25% and 100%; confidence level – low
HOLD:	Target price offers upside of less than 25%
SELL:	Target price at or below current price levels

SOVLINK LLC

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

Kremlin Embankment 1, building 2,
Moscow 119019, Russia
www.sovlink.ru
research@sovlink.ru

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