SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

November 22, 2006

Regional natural gas distributors

Industry Review

The potential of the last mile

Analyst:
Nikolay Saperov
saperovn@sovlink.ru

Nizhegorodoblgaz: BUY

UPSIDE: 48%
Target Price: US$4.9

PERFORMANCE 2006E			
Revenue (US$ mn)	65.5	P/S	1.4
EBITDA(US$ mn)	20.2	EV/EBITDA	4.4
Net Income (US$ mn)	15.6	P/E	5.9

Voronezhoblgaz: BUY

UPSIDE: 78 %
Target Price: US$4.2

PERFORMANCE 2006E			
Revenue (US$ mn)	50.9	P/S	1.0
EBITDA(US$ mn)	10.7	EV/EBITDA	4.6
Net Income (US$ mn)	5.8	P/E	9.0

Rostovoblgaz: BUY

UPSIDE: 67%
Target Price: US$648

PERFORMANCE 2006E			
Revenue (US$ mn)	59.2	P/S	0.8
EBITDA(US$ mn)	9.5	EV/EBITDA	6.0
Net Income (US$ mn)	6.1	P/E	7.6

Valuation comparison

	P/S	P/BV	P/E	EV/ EBITDA
Oblgazes	**1.0**	**1.3**	**8.6**	**5.2**
Nearest global peers	2.4	2.0	14.0	7.0
Eastern Europe	1.1	2.1	21.0	8.0
Western Europe	1.7	2.8	22.0	8.5
Average	**1.7**	**2.3**	**19.0**	**7.8**
Discount to global peers, including a 30% discount for non-transparency	46%	52%	85%	36%

• In this report, we examine regional natural gas distribution companies (known as “oblgaz-es” in Russian), one of the most interesting emerging sectors among low-liquidity equities. The investment potential of oblgaz shares comes from domestic gas market liberalization in Russia and price increases for industrial consumers. Gas price growth will undoubtedly increase cashflows at oblgazes, as the transport tariff is directly proportional to the domestic gas price.

• Oblgazes are a strategically significant segment of the Russian natural gas system. These distribution companies occupy the last-mile segment in the gas distribution chain by transporting gas from trunk pipelines directly to consumers—residents and industrial enterprises. Natural gas distribution remains the most fragmented segment of the gas market in Russia. Currently, Gazprom does not have controlling stakes in all regional distribution companies, although it has been building its stakes in recent years. At the same time, the consolidation of gas distribution assets is a requirement for gas market reform and liberalization.

• In a number of regions, oblgazes are merely operators of gas distribution networks, but not owners. In these cases, low- and medium-pressure networks are leased from city/regional administrations. We believe that Gazprom will consolidate its gas distribution assets via buyouts, in order to create a vertically-integrated chain (i.e. city gas distributors–regional gas distributors–Gazprom)

• Oblgazes have stable cashflows, which mostly come from the transport tariff that is approved for each distributor by the Federal Tariff Service (FTS). Moreover, a number of oblgazes receive an “investment surcharge” from buyers, as well as financing from Gazprom in order to buy networks that they do not already own. The investment programs at several oblgazes are in line with the company’s capitalization (i.e. Nizhegorodoblgaz).

• The presence of investment potential is confirmed by the fundamental undervaluation of Russian natural gas distribution companies relative to their foreign peers. DCF modeling and comparative valuation results suggest 50%–100% upside on various oblgazes.

Contents:

Tel.: +7 495 967 1300
Fax : +7 495 967 1311
research@sovlink.ru

Oblgaz' role in the Russian natural gas sector

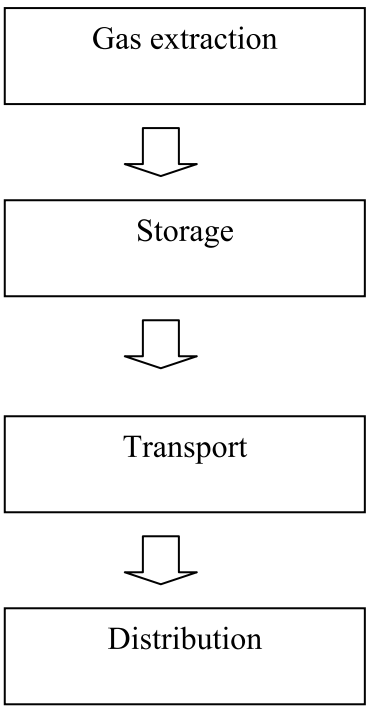
• Oblgazes are a part of the Russian gas distribution network, which consists of roughly 220 gas-distribution organizations (GROs). Besides oblgazes, GROs also encompass gorgazes and mezhraigazes, which are responsible for a more intense level of gas supply—to consumers in large cities and densely populated regions, respectively.

• Oblgazes are operators and—in most cases—owners of gas distribution networks of low- and medium-pressure pipelines. The Russian natural gas distribution system is one of the largest networks in the world—low- and medium-pressure gas pipelines measure 535,000 km across the country. In 2005, natural gas distribution pipelines supplied residential and industrial consumers with 307 bn m^3 of natural gas.

• Oblgazes are regional monopolists. Each oblgaz works exclusively in its own region.

• Oblgazes occupy the last leg in the gas distribution chain, by transporting gas from the gas-main pipeline directly to consumers—the populace and industrial enterprises. Oblgazes and gorgazes are the "last mile" in Russia's gas transport system, and are thus a strategically important segment of the Russian natural gas system.

Russian gas industry setup



The gas extraction capacity in Russia was 548 bn m^3 in 2005. Sales volume to domestic consumers reached 307 bn m^3.

Underground gas storage units allow companies to adjust for seasonality in gas consumption. There are 24 gas storage units located on Russian territory.

Transport is conducted via high-pressure gas-main pipelines, which are completely controlled by Gazprom. The gas transport tariff is approved for each distributor by the Federal Tariff Service (FTS). Russia's gas-main pipeline system is the largest in the world, at 155,000 km.

The final leg of the Russian gas transport system is low- and medium-pressure gas distribution networks. Oblgazes and gorgazes are the owners or leasers of such networks.

Source: Sovlink

• Natural gas distribution remains the most fragmented segment of the Russian gas market. Without Gazprom having complete control over this segment, we believe we are unlikely to see much movement in gas market reform and price liberalization on the domestic market.

Gas reform consists of two stages:

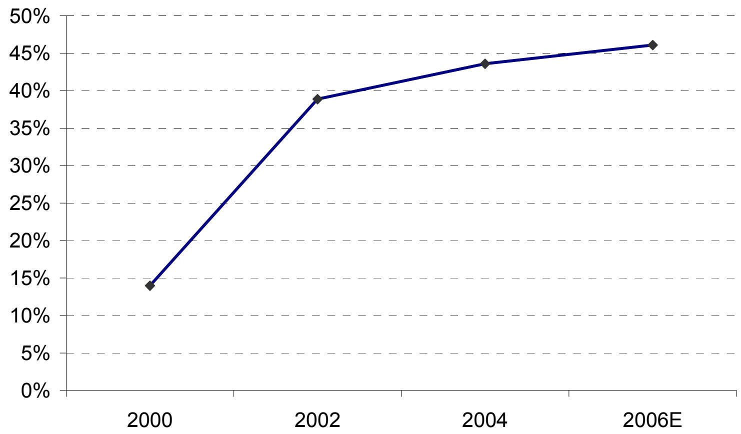
1. Asset consolidation within separate segments.
2. Separation of consolidated assets into new structures.

• Theoretically, the reforms should ultimately divide companies by their responsibility: Prospecting, Extraction, Transport, Processing, Storage and Distribution.

• The most active movements are being made in the distribution segment, which Gazprom did not control until recently. In 2004, Gazprom created a subsidiary called JSC Gazpromregiongaz (now called Regiongazholding). All distribution networks owned by GROs (gas distribution organizations) are consolidated in this subsidiary. Gazprom maintains that the consolidation is necessary in order to provide efficiency for investing in the development of distribution infrastructure.

• Gazprom controls 179 of 220 regional distribution organizations. The gas monopoly's share in oblgazes has grown steadily over the last several years, and continues to increase.

Gazprom's average share in oblgazes

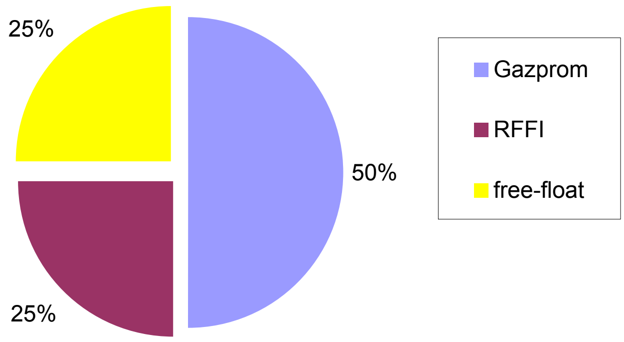


Source: Sovlink estimates

• Gazprom has already consolidated a controlling stake in most of the oblgazes. In 2000, Gazprom's average stake in oblgazes was less than 15%. From 2000–06, Gazprom bought out oblgaz management and workers' shares. Gazprom's aim is to increase its share in the oblgazes from its current controlling stake, up to 75% in 2008.

• Most oblgazes have a nearly identical share capital structure. In most cases, the controlling stake is owned by Gazprom (through Regiongazholding), the blocking stake is owned by the Federal Property Fund (RFFI) and a few blocks are included in the 2007 privatization plan. Other shares are held by individuals or traded on the stock market.

Average oblgaz share capital structure



Source: Company data, Sovlink estimates

Share capital structure of select oblgazes

	Gazprom	RFFI	Municipal property	Others
Nizhegorodoblgaz	58%	25%	7%	10.00%
Voronezhoblgaz	50%	25%	6%	19.00%
Tveroblgaz	55.11%	22.70%	-	22.19%
Tambovoblgaz	50.78%	25.50%	-	23.72%
Smolenskoblgaz	61.36%	15.94%	-	22.70%
Rostovoblgaz	51.38%	25.50%	-	23.12%
Komigaz	60%	-	-	40.00%
Saratovoblgaz	54.80%	25.50%	-	19.70%
Yaroslavloblgaz	50%	25.50%	2%	22.50%

Source: Company data, Sovlink estimates

• The main oblgaz shareholders are Gazprom (through Regiongazholding), the RFFI and regional administrations. Stakes owned by private individuals range from 10.8% (Nizhegorodoblgaz) to 40% (Komigaz).

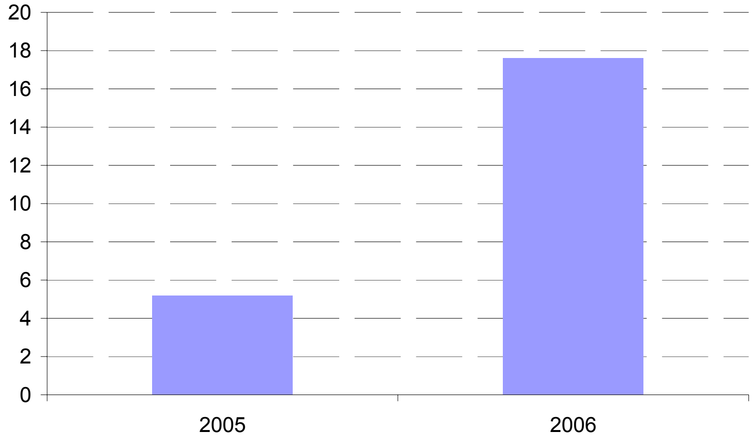
Why control of oblgazes is significant for Gazprom

We outline Gazprom's interests in gas distribution assets:

• **"Last mile" control in distribution chain**
We estimate that gas in the distribution system that is unaccounted for could be up to 10% of Gazprom's cashflows.

• **Ensuring its investments**
The deterioration of gas distribution networks has already exceeded 60% in several regions. As a result, a large regional gasification program is planned through 2008. This year, money reserved for the regional gasification program was increased dramatically—to 18 bn rubles (c$667 mn), from just 5 bn rubles (c$179 mn) in 2005.

Gasification investment, bn rubles



Source: Gazprom

• Gazprom needs to consolidate assets in all segments of the gas market on the eve of probable gas market reform and natural gas market liberalization.

Cashflow structure

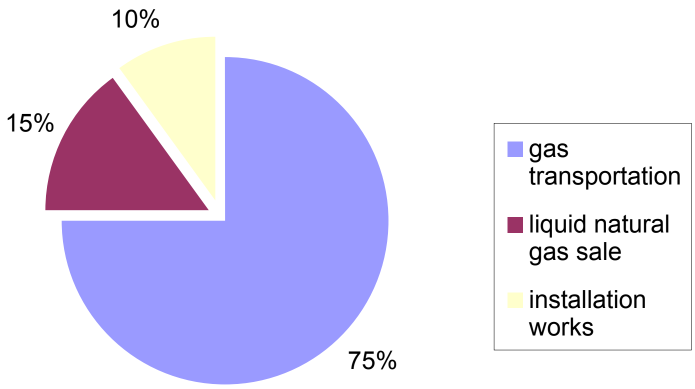
Oblgazes' cashflows comes from three areas:

1) A fixed tariff for gas transportation (as set by the FTS for each region)—70%–85% of revenues, on average.

2) Earnings from liquid natural gas sales—10%–15% of revenues on average, but can sometimes reach 30%.

3) Gas pipeline construction, installation works—5%–10% of revenues on average.

Revenue structure



Source: Company data, Sovlink estimates

Revenue share breakdown

	Gas transportation volume, bn m^3	Tariff for 100 m^3, Rub	Transportation	Liquefied gas sales	Other
Nizhegorodoblgaz	8	145	84%	0%	16%
Voronezhoblgaz	5	106	49%	40%	11%
Tveroblgaz	2.6	167	73%	14%	13%
Tambovoblgaz	1.8	180	65%	15%	20%
Smolenskoblgaz	3.2	66	31%	19%	50%
Rostovoblgaz	6.65	130	69%	16%	15%
Komigaz	3.25	74	78%	11%	11%
Saratovoblgaz	2	244	85%	0%	15%
Yaroslavloblgaz	1.5	74	38%	35%	27%

Source: Company data, Sovlink estimates

• A transport tariff is approved for each distributor by the FTS, and sometimes includes an "investment surcharge." Cash received by oblgazes in the form of the surcharge is mainly spent on buying pipelines from regional governments, which we see as a logical part of Gazprom's plans of taking control over the gas distribution segment in Russia. The investment programs at several oblgazes are roughly equal to the company's capitalization (i.e. Nizhegorodoblgaz). Oblgazes with a large amount of gas transport revenue (Nizhegorodoblgaz and Saratovoblgaz) gain more than others, because of receiving an "investment surcharge."

Assets

• Regional gas distribution companies' assets consist of low- and medium-pressure gas distribution networks, as well as assets connected to gas distribution services: boiler-houses, gas distribution stations, gas-regulating stations and electro-protection stations. In some cases, oblgazes have non-core assets such as sanitariums on their balance sheets. Most of the oblgazes do not own 100% of their distribution networks. For example, Nizhegorodoblgaz owns only 25% of its network, and Rostovoblgaz owns slightly more than 50%. Oblgazes with low ownership in their networks receive an "investment surcharge" as well as financing from Gazprom to buy out the networks on their own balance sheets.

A brief history of oblgazes

- **1991**
  The distribution segment was removed from the vertically-integrated structure during privatization.

- **1997**
  The Mezhregiongaz holding was created to manage regional oblgazes

- **2001**
  When Alexei Miller became head of Gazprom, the monopoly succeeded in returning controlling stakes in many oblgazes through bankruptcy procedures and share buyouts.

- **2006**
  At the moment, Gazprom controls 179 of 220 gas distribution companies. Interest in other stakes is highlighted by the monopoly's desire to consolidate a minimum 75% stake in each oblgaz.

Valuation

• We value the oblgazes through two methodologies: DCF and comparative multiples.

• Given that the oblgazes have steady and predictable cashflows, a DCF valuation seems to be applicable in spite of the companies' RAS accounts and non-transparency. In our DCF model, we assume that the transportation volume in each Russian region remains at about the current level, and that the transport tariffs growing according to the FTS' declared rates—8%–14% per year. The average transport tariff in Russia is $5/'000 m³ of gas. When valuing the cashflows of the oblgazes that have a lower-than-average tariff, we assumed higher growth rates. For oblgazes with a higher-than-average tariff, we applied lower rates of growth.

• In creating a comparative valuation, we used three categories: the closest global companies by size and business structure, Eastern European distribution companies, and Western European distribution companies.

• A replacement cost valuation does not give accurate results, as many regional distribution networks are not owned by oblgazes, but only rented. Likewise, liquidation values are not germane, as oblgazes' own not only low-pressure gas pipelines, but also non-core assets such as sanitariums.

Oblgaz financial indicators, 2006E, $ mn

	Sales	EBITDA	Assets	BV	PPE	Net profit
Nizhegorodoblgaz	65.5	20.2	63.8	27.7	28.4	15.6
Voronezhoblgaz	50.9	10.7	86.5	56.8	52.4	5.8
Tveroblgaz	25.2	6.4	54.4	50.8	38.6	2.3
Tambovoblgaz	20.9	5.4	34.5	16.9	21.8	1.7
Smolenskoblgaz	28.2	2.7	26.7	18.9	17.5	0.9
Rostovoblgaz	59.2	9.5	94.2	69.9	59.0	6.1
Komigaz	11.6	3.5	17.9	13.4	12.5	1.6
Saratovoblgaz	23.2	2.4	62.0	17.7	29.9	0.5
Yaroslavloblgaz	12.7	1.9	9.5	7.9	4.7	1.0

Source: Company data, Sovlink estimates

• In our DCF models, we applied a 20% discount rate based on our WACC estimates and a 3% growth rate following the terminal period.

DCF valuation

	Gas transportation volume, bn m^3	Tariff for 100 m^3, $	Transportation share in revenues	Revenues, 2006E $ mn	DCF-valuation, $ mn	Number of shares
Nizhegorodoblgaz	8	145	84%	65.46	126.51	27,778,800
Voronezhoblgaz	5	106	49%	50.86	90.51	22,173,400
Tveroblgaz	2.6	167	73%	25.17	49.96	178,468
Tambovoblgaz	1.8	180	65%	20.88	21.91	864,020
Smolenskoblgaz	3.2	66	31%	28.21	19.84	401,416
Rostovoblgaz	6.65	130	69%	59.17	71.24	120,246
Komigaz	3.25	74	78%	11.58	18.11	343,772
Saratovoblgaz	2	244	85%	23.24	21.19	3,678,100
Yaroslavloblgaz	1.5	74	38%	12.73	13.77	69,706

Source: Company data, Sovlink estimates

Comparative valuation

	P/S	P/A	P/BV	P/PPE	P/E	EV/EBITDA
Russian companies	1.03	0.67	1.31	1.28	8.58	5.18
Nearest global peers	2.36	1.04	1.97	1.91	14.00	7.00
Eastern Europe	1.10	1.10	2.12	0.87	21.00	8.00
Western Europe	1.68	0.96	2.78	1.00	22.00	8.50
Average	1.71	1.03	2.29	1.26	19.00	7.83
Discount to global peers, including a 30% discount for non-transparency	46%	38%	52%	-1%	85%	36%

Source: Bloomberg, Sovlink estimates

• The results of our comparative valuation suggest the general undervaluation of Russian gas distribution companies relative to their global peers on all multiples, even considering the 30% discount we applied.

Oblgaz comparative valuation

	P/S	P/A	P/BV	P/PPE	P/E	EV/EBITDA
Nizhegorodoblgaz	1.4	1.4	3.3	3.2	5.9	4.4
Voronezhoblgaz	1.0	0.6	0.9	1.0	9.0	4.6
Tveroblgaz	1.1	0.5	0.5	0.7	11.8	3.5
Rostovoblgaz	0.8	0.5	0.7	0.8	7.6	6.0
Saratovoblgaz	0.8	0.3	1.1	0.7	-	7.4
Global average	1.7	1.0	2.3	1.3	19.0	7.8

Source: Sovlink estimates

Fair values of Russian regional gas distributors

	DCF valuation, $ mn	Comparative valuation, $ mn	Average valuation, $ mn	Price, $	Fair value, $	Upside, %
Nizhegorodoblgaz	126.5	144.5	135.5	3.3	4.9	48%
Voronezhoblgaz	90.5	94.5	92.5	2.35	4.2	78%
Rostovoblgaz	71.2	84.5	77.9	387.5	648	67%

Source: Sovlink estimates

Nizhegorodoblgaz

COMPANY NOTE

BUY

UPSIDE: 48%

Target Price: US$4.9

Analyst:
Nikolay Saperov
saperovn@sovlink.ru

STOCK DATA

Ticker	nnog	MCap (US$ mn)	92
Shares Ords	27,778,800	Free Float, %	10%
Shares Pref	-	Free Float (US$ mn)	9
Bid Ords (US$)	2.8	Offer Ords (US$)	3.8

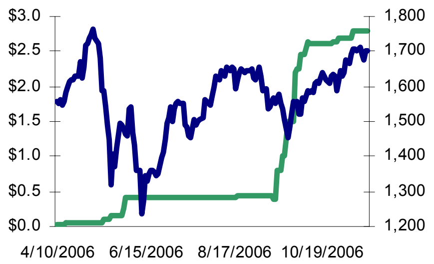
MARKET PERFORMANCE

		1 month	6 months
Absolute	Ords	23%	238%
	Prefs	-	-
Relative to RTSI	Ords	18%	228%
	Prefs	-	-
Price range (US$)			
High	Ords	2.7	2.7
Low		2.2	0.8

PERFORMANCE 2006E

Revenue (US$ mn)	65.5	P/S	1.4
EBITDA(US$ mn)	20.2	EV/EBITDA	4.4
Net Income (US$ mn)	15.6	P/E	5.9

NNOG RELATIVE PERFOMANCE



Source: RTS, Sovlink Securities

• We see a large likelihood that Gazprom will make Nizhegorodoblgaz the "test case" for its ultimate consolidation of gas distribution systems. As such, we emphasize Nizhegorodoblgaz' large size—it is in the top fifth of oblgazes by revenue and assets—as well as its high profitability and large investment program till 2008.

• Nizhegorodoblgaz is the one of the largest gas distribution companies by revenue and assets, and is also one of the most profitable, with an EBITDA margin of 25%, and net margin of 15%. This compares to industry averages of 18% and 6%, respectively. We expect a net margin of 19% for 2006.

• The length of gas distribution systems in the Nizhegorodskaya district is more then 17,000 km, roughly 11% of the entire Russian gas network system. The volume of gas distribution in the district was 8 bn m^3 in 2005, with a transport price of 145 rubles for 1,000 m^3. The transport price, with an "investment surcharge" of 10%, is to increase 25% to 181 rubles, which—according to our expectations—should bring rapid growth in revenues, net profit and EBITDA margin. As the "investment surcharge" allows Nizhegorodoblgaz to finance capex, the company should be able to increase its free cashflow, which we reflect in our DCF model.

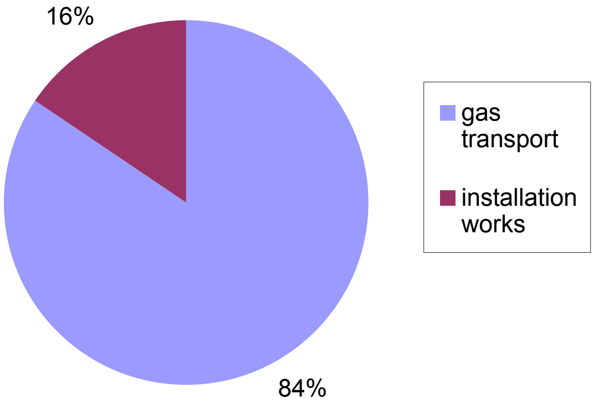
• We expect revenues to increase 30% in 2006, which should also give plenty of growth to net profit and EBITDA (under RAS).

• We value Nizhegorodoblgaz shares via a DCF model and comparative multiples. As a result, we come to a fair value of $4.9 per share, which implies 48% upside from current prices. We rate the stock a **BUY**.

• Nizhegorodoblgaz operates a network of low- and medium-pressure gas delivery pipelines in the Nizhegorodskaya district. The company transported 8 bn m^3 of gas in 2005, and should increase deliveries to 8.2 bn m^3 in 2006, where it should stay for the next few years.

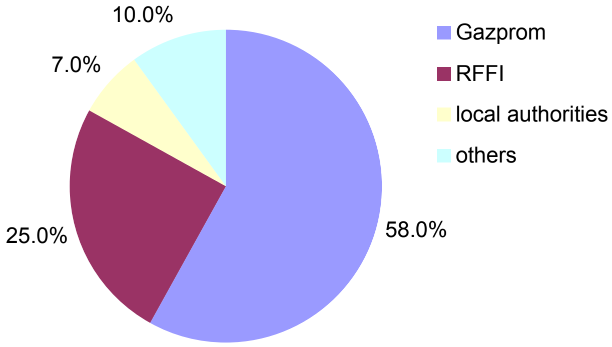
• Nizhegorodoblgaz does not sell liquid gas. As such, its revenue is derived from its transport tariffs and the servicing of gas distribution networks.

Nizhegorodoblgaz revenue structure, 2005



Source: Company data

Nizhegorodoblgaz ownership structure



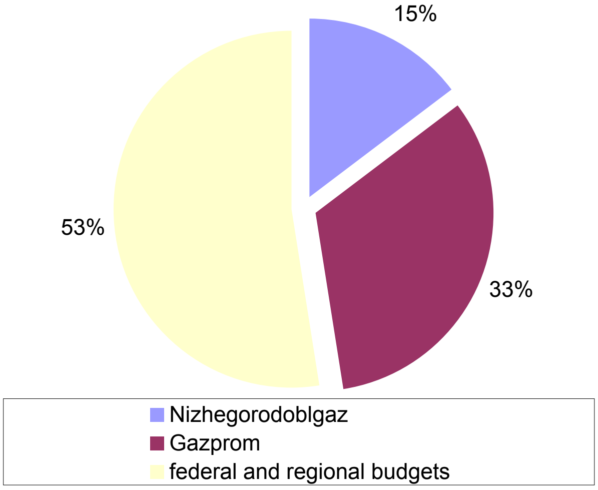
Source: Company data, Sovlink estimates

As shown in the chart above, Gazprom controls 58% of Nizhegorodoblgaz. We estimate the company's freefloat at 10%.

Investment Program

• Investments in the Nizhegorodskaya district gas distribution system are planned at $35 mn in 2006 and $93 mn through 2008. The amount of the three-year investment plan is 50% more then Nizhegorodoblgaz' current assets.

The structure of investment financing at Nizhegorodoblgaz in 2006



Source: Company data, Sovlink estimates

• The investments Nizhegorodoblgaz makes by itself are financed entirely from the "investment surcharge," which in the end is paid by consumers.

• The company plans to acquire its gas distribution network, which is currently owned by the regional government. We estimate that Nizhegorodoblgaz owns no more then 25% of the region's gas distribution network, and the company rents the remainder from the regional government.

VALUATION

Comparative method

	P/S	EV/A	P/E	EV/EBITDA
International peers	1.7	1.0	19	7.8
		2006E		
	Sales, $mn	Assets, $ mn	Net profit, $mn	EBITDA, $mn
	65.5	71.0	12.4	20.2
Estimated M.Cap, $ mn	112.0	73.1	235.1	157.8
weight	25%	25%	25%	25%
Average weighted fair capitalization, $ mn				**144.5**
Fair value, $				**5.2**

Source: Sovlink estimates

DCF model, $ mn

	2005	2006E	2007E	2008E	2009E	2010	2011E	2012E	2013E	2014E	2015E
Volume of gas transportation, bn m^3	8	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2
Tariff, rubles	145.0	181.3	199.4	219.3	241.2	265.4	291.9	321.1	353.2	388.5	427.4
Revenues from transportation of gas	42.18	55.46	62.88	69.17	76.08	83.69	92.06	101.27	111.40	122.53	134.79
Revenues from sales of LPG	0	0	0	0	0	0	0	0	0	0	0
Revenues from technical service and fixes	7.8	10	10	10	10	10	10	10	10	10	10
Revenues	50.0	65.5	72.9	79.2	86.1	93.7	102.1	111.3	121.4	132.5	144.8
COGS	33.0	40.6	45.2	49.1	53.4	58.1	63.3	69.0	75.3	82.2	89.8
Gross profit	17.0	24.9	27.7	30.1	32.7	35.6	38.8	42.3	46.1	50.4	55.0
Gross margin, %	34%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%
Amortization	1.5	1.9	2.1	2.3	2.2	2.3	2.6	2.8	3.0	3.3	3.3
Cashflow from non-operating activities	6.0	6.5	7.3	8.7	9.5	10.3	10.2	11.1	12.1	13.3	14.5
EBITDA	12.5	20.2	22.5	23.7	25.4	27.6	31.1	33.9	37.0	40.4	43.9
EBITDA margin, %	24.9%	30.9%	30.9%	29.9%	29.5%	29.5%	30.5%	30.5%	30.5%	30.5%	30.3%
Interest payments	0.33	0.65	0.73	0.79	0.86	0.75	0.82	0.89	0.97	1.06	1.16
Amortization	1.45	1.90	2.11	2.30	2.15	2.34	2.55	2.78	3.03	3.31	3.33
EBT	10.7	17.7	19.7	20.6	22.4	24.5	27.8	30.3	33.0	36.0	39.4
Net profit	7.5	12.4	13.8	14.4	15.7	17.2	19.4	21.2	23.1	25.2	27.6
Net margin, %	14.9%	18.9%	18.9%	18.2%	18.2%	18.3%	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Sovlink

Tel.: +7 495 967 1300
Fax : +7 495 967 1311
research@sovlink.ru

DCF model, $ mn (continued)

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	50.0	65.5	72.9	79.2	86.1	93.7	102.1	111.3	121.4	132.5	144.8
Gross profit	17.0	24.9	27.7	30.1	32.7	35.6	38.8	42.3	46.1	50.4	55.0
Non-COGS	6.0	6.5	7.3	8.7	9.5	10.3	10.2	11.1	12.1	13.3	14.5
EBITDA	12.5	20.2	22.5	23.7	25.4	27.6	31.1	33.9	37.0	40.4	43.9
Amortization & depreciation	1.5	1.9	2.1	2.3	2.2	2.3	2.6	2.8	3.0	3.3	3.3
EBIT	11.0	18.3	20.4	21.4	23.2	25.3	28.6	31.2	34.0	37.1	40.5
Interest payments	0.3	0.7	0.7	0.8	0.9	0.7	0.8	0.9	1.0	1.1	1.2
Net profit	7.5	12.4	13.8	14.4	15.7	17.2	19.4	21.2	23.1	25.2	27.6
EBITDA margin, %	25%	31%	31%	30%	30%	30%	31%	31%	31%	31%	30%
Net margin, %	15%	19%	19%	18%	18%	18%	19%	19%	19%	19%	19%
Net profit	7.5	12.4	13.8	14.4	15.7	17.2	19.4	21.2	23.1	25.2	27.6
Amortization & depreciation	1.5	1.9	2.1	2.3	2.2	2.3	2.6	2.8	3.0	3.3	3.3
Capex	1.1	2.5	2.5	2.5	2.0	2.0	1.0	1.0	1.0	1.0	1.0
FCFF	7.8	11.8	13.4	14.2	15.8	17.5	21.0	23.0	25.1	27.5	29.9
FCFF discounted		10.0	9.6	8.6	8.2	7.7	7.8	7.2	6.7	6.2	5.7

Source: Sovlink

WACC	16%
Terminal growth rate	3%
NPV of forecasted years	77.65
NPV of Terminal value	45.3
Fair EV, $ mn	122.9
Net debt, $ mn	-3.6
Fair M.Cap, $ mn	126.5
Fair value, $	4.55

Source: Sovlink

Price target derivation

Comparative valuation	5.2
DCF	4.55
Average valuation	**4.9**

Source: Sovlink

Voronezhoblgaz

COMPANY NOTE

BUY
UPSIDE: 78%
Target Price: US$4.2

Analyst:
Nikolay Saperov
saperovn@sovlink.ru

STOCK DATA

Ticker	vogz	MCap (US$ mn)	52
Shares Ords	22,173,400	Free Float, %	19%
Shares Pref	-	Free Float (US$ mn)	10
Bid Ords (US$)	2.25	Offer Ords (US$)	2.45

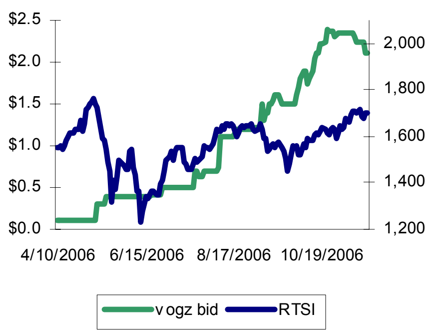
MARKET PERFORMANCE

		1 month	6 months
Absolute	Ords	57%	-
	Prefs	-	-
Relative to RTSI	Ords	51%	432%
	Prefs	-	-
Price range (US$)			
High	Ords	2.5	5
Low		1.75	1.5

PERFORMANCE 2006E

Revenue (US$ mn)	50.9	P/S	1.0
EBITDA(US$ mn)	10.7	EV/EBITDA	4.6
Net Income (US$ mn)	5.8	P/E	9.0

VOGZ RELATIVE PERFOMANCE



Source: RTS, Sovlink Securities

• Similar to Nizhegorodoblgaz, Voronezhoblgaz, is the one of the main gas distributors by revenues and assets. The company has assets of $86 mn, exceeding Nizhegorodoblgaz. In 2006, we expect the company to post an EBITDA margin of 21% and net margin of 12%, both above the industry average.

• Voronezhoblgaz uses a gas network of over 16,000 km, of which it owns about 12,000 km—75% of its network. The Voronezhskaya district is the leader among Russians regions in creating new gas distribution systems. The gas network system in that region has increased by 5,000 km—more than 30%—over the last five years. In 2006, the company put another 1,600 km of gas network into operation. The level of gasification in the region increased from 54% to 65.4%, and from 18% to 32% in the region's countryside.

• The volume of gas supplied to the Voronezhskaya district was about 5 bn m^3 in 2005, at a transport rate of 106 rubles for 1,000 m^3.

• Gazprom and the Voronezhskaya district administration signed a cooperation agreement for five years in 2003. According to that agreement, the gasification program of the region is being implemented through 2009.

• The volume of direct investment in developing the gas distribution network increased from $7.5 mn in 2003 to $36 mn in 2006.

• The investment case for Voronezhoblgaz is strengthened by the active addition of new gas distribution systems in the region—the gas distribution systems in the region will measure more than 20,000 km in 2010. Voronezhoblgaz receives revenues from transporting gas, and also from servicing the gas network. The company also receives orders from Gazprom to service its network of low- and medium-pressure pipelines.

• We value Voronezhoblgaz shares by a DCF model and comparative multiples. Our valuation suggests a fair value of $4.2 per share, implying potential growth of 78% from current levels.

• Voronezhoblgaz is one of the largest regional gas distributors by revenues and assets. Its financial results have been increasing over the last few years, as a result of gasification in the region.

Voronezhoblgaz financials, $ mn

	2004	2005	2006E
Sales	30.5	39	50.9
EBITDA	7.1	7.6	10.7
Net profit	3	4.4	6.2
EBITDA margin, %	23%	19%	21%
Net margin, %	10%	11%	12%

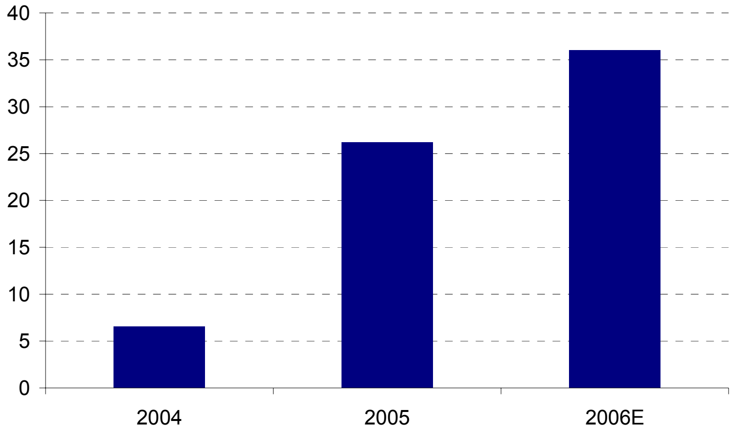
Source: Company data, Sovlink estimates

Investment Program

• The Voronezhskaya district is the leader among Russians regions in gasification and the creation of new gas distribution systems.

• So far, $196 mn has been invested in developing gas distribution systems in the area, including $73 mn in 2005. Planned investment in 2006 is $111 mn, including $36 mn from Gazprom.

Gazprom's investments in the Voronezhskaya district gas industry, $ mn



Source: Gazprom

Gasification levels

	Overall	Cities	Countryside
Voronezhskaya district	64%	83%	32%
Russian average	53%	60%	34%

Source: Gazprom

• The general level of gasification in the Voronezhskaya district is higher than the Russian average; however, the level of gasification in the countryside is lower than average. As such, the priority sector of development for the Voronezhskaya district gas industry is the creation of low- and medium-pressure gas networks in the countryside and between country settlements. This network will be served by Voronezhoblgaz.

• Voronezhskaya district Governor Vladimir Kulakov approved a gasification program through 2009. The program calls for gas distribution systems in the region to stretch to more than 20,000 km in 2009. More than 1,000 boiler-houses will be switched to gas from fuel oil and electricity.

• Financing for Voronezhoblgaz' investment program comes from three sources: Gazprom, state and district budgets, and the "investment surcharge." As mentioned above, in 2006 investment will hit $111 mn, with Gazprom contributing $36 mn, budget money coming to $48 mn, and the "investment surcharge" bringing in $27 mn.

Valuation

Comparative method

	P/S	EV/A	P/E	EV/EBITDA
International peers	1.7	1.0	19	7.8
			2006E	
Voronezhoblgaz	Sales, $ mn	Assets, $ mn	Net profit, $ mn	EBITDA, $ mn
	50.9	88	6.2	10.7
Estimated M.Cap, $ mn	87.0	90.6	117.0	83.3
Weight	25%	25%	25%	25%
Average weighted fair capitalization, $ mn				**94.5**
			Fair value, $	**4.3**

Source: Sovlink estimates

DCF model, $ mn

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Volume of gas transportation, bn m^3	5	5.1	5.1	5.2	5.2	5.2	5.3	5.3	5.4	5.4	5.4
Tariff, rubles	106.0	132.5	152.4	175.2	194.5	215.9	239.7	266.0	295.3	327.8	363.8
Revenues from transportation of gas	19.3	25.2	29.9	35.0	38.9	43.2	48.9	54.2	61.3	68.1	75.6
Revenues from sales of LPG	15.7	20.4	24.5	29.4	34.2	39.6	46.0	53.3	61.8	71.7	83.2
Revenues from technical service and fixes	4.0	5.2	6.2	7.5	8.4	9.4	10.5	11.8	13.2	14.8	16.6
Revenues	39.0	50.9	60.7	72.0	81.4	92.2	105.3	119.3	136.4	154.6	175.3
COGS	31.2	40.4	48.5	58.3	66.0	74.7	85.3	96.6	110.5	125.2	142.0
Gross profit	7.8	10.4	12.1	13.7	15.5	17.5	20.0	22.7	25.9	29.4	33.3
Gross margin, %	20%	21%	20%	19%	19%	19%	19%	19%	19%	19%	19%
Amortization	1.2	1.8	2.1	2.5	2.9	3.2	3.7	4.2	4.8	5.4	6.1
Cashflow from non-operating activities	1.5	1.5	1.7	2.0	2.3	2.6	2.9	3.3	3.8	4.3	4.9
EBITDA	7.6	10.7	12.6	14.2	16.0	18.2	20.7	23.5	26.9	30.5	34.5
EBITDA margin, %	19.4%	21.0%	20.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%
Interest payments	0	0.10	0.12	0.14	0.16	0.18	0.21	0.24	0.27	0.31	0.35
Amortization	1.2	1.8	2.1	2.5	2.9	3.2	3.7	4.2	4.8	5.4	6.1
EBT	6.3	8.8	10.3	11.5	13.0	14.8	16.9	19.1	21.8	24.7	28.1
Net profit	4.4	6.2	7.2	8.1	9.1	10.3	11.8	13.4	15.3	17.3	19.6
Net margin, %	11.3%	12.1%	11.9%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%

Source: Company data, Sovlink estimates

DCF model, $ mn (continued)

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	39.0	50.9	60.7	72.0	81.4	92.2	105.3	119.3	136.4	154.6	175.3
Gross profit	7.8	10.4	12.1	13.7	15.5	17.5	20.0	22.7	25.9	29.4	33.3
Non-COGS	1.5	1.5	1.7	2.0	2.3	2.6	2.9	3.3	3.8	4.3	4.9
EBITDA	7.6	10.7	12.6	14.2	16.0	18.2	20.7	23.5	26.9	30.5	34.5
Amortization & depreciation	1.2	1.8	2.1	2.5	2.9	3.2	3.7	4.2	4.8	5.4	6.1
EBIT	6.3	8.9	10.4	11.7	13.2	14.9	17.1	19.3	22.1	25.0	28.4
Interest payments	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.4
Net profit	4.4	6.2	7.2	8.1	9.1	10.3	11.8	13.4	15.3	17.3	19.6
EBITDA margin, %	19%	21%	21%	20%	20%	20%	20%	20%	20%	20%	20%
Net margin, %	11%	12%	12%	11%	11%	11%	11%	11%	11%	11%	11%
Net profit	4.4	6.2	7.2	8.1	9.1	10.3	11.8	13.4	15.3	17.3	19.6
Amortization & depreciation	1.2	1.8	2.1	2.5	2.9	3.2	3.7	4.2	4.8	5.4	6.1
Capex	0.4	1.7	1.8	2.0	1.5	1.5	1.5	1.5	1.5	1.5	1.5
FCFF	5.3	6.2	7.5	8.6	10.5	12.1	14.0	16.0	18.5	21.2	24.3
FCFF discounted		5.3	5.4	5.2	5.4	5.3	5.2	5.0	4.9	4.8	4.6

Source: Sovlink estimates

WACC	16%
Terminal growth rate	3%
NPV of forecasted years	51.17
NPV of terminal value	36.7
Fair EV, $ mn	87.9
Net debt, $ mn	-2.6
Fair M.Cap, $ mn	90.5
Fair value, $	4.08

Source: Sovlink estimates

Price target derivation

Comparative valuation	4.3
DCF valuation	4.1
Average	4.2

Source: Sovlink estimates

Tel.: +7 495 967 1300
Fax : +7 495 967 1311

research@sovlink.ru

SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

November 22, 2006

Rostovoblgaz

COMPANY NOTE

BUY

UPSIDE: 67%

Target Price: US$648

Analyst:
Nikolay Saperov
saperovn@sovlink.ru

STOCK DATA

Ticker	rtbg	MCap (US$ mn)	47
Shares Ords	120,246	Free Float, %	23%
Shares Pref	21,682	Free Float (US$ mn)	11
Bid Ords (US$)	365	Offer Ords (US$)	410
Bid Prefs (US$)	255	Offer Prefs (US$)	310

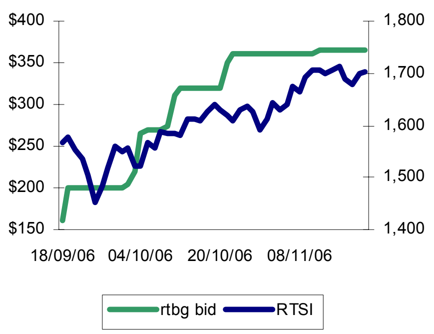
MARKET PERFORMANCE

		1 month	6 months
Absolute	Ords	43%	-
	Prefs	-	-
Relative to RTSI	Ords	37%	-
	Prefs	-	-
Price range (US$)			
High	Ords	465	465
Low		290	290

PERFORMANCE 2006E

Revenue ($ mn)	59.2	P/S	0.8
EBITDA($ mn)	9.5	EV/EBITDA	6.0
Net income ($ mn)	6.1	P/E	7.6

RTBG RELATIVE PERFOMANCE



Source: RTS, Sovlink Securities

• Rostovoblgaz is one of the main gas distribution companies, with revenues of more then $50 mn. The company is larger than Voronezhoblgaz, with assets of $100 mn. We expect the company to post profitability on the industry-average level in 2006.

• The low- and medium-pressure gas distribution network in the Rostov district stretches for 20,000 km, and Rostovoblgaz owns about 55% of the network. The volume of gas transported in the Rostov district was 6.9 bn m^3 in 2005, and has not changed significantly this year. The average transport price for Rostovoblgaz was 130 rubles per 1,000 m^3 in 2005, plus an "investment surcharge" of 32 rubles from 2006.

• Rostovoblgaz receives roughly 70% of its revenues from the transportation of gas, 15% from the sale of LPG and 15% from servicing gas networks.

• As a result of increasing of the volume of gas transported by 10% and a 30% tariff increase, Rostovoblgaz' revenues rose 46% year-on-year in 1H06. The company's EBITDA and net profit grew even faster: EBITDA climbed 150%, while net profit jumped sixfold.

• The Rostov district has had a new scheme of financing the development of gas distribution systems from 2006. The district's budget will provide for development by giving credit to Rostovoblgaz at 1/3 of the refinancing rate, which should help the company acquire networks.

• We value Rostovoblgaz's shares by a DCF model and on comparative multiples. Our valuation suggests a fair price of $648 per share, implying 67% growth from current levels. Applying a discount of 30% to the ordinary shares—in line with what the market currently uses—we arrive at a fair value of $454 per preferred share, suggesting 60% potential growth.

• Rostovoblgaz is roughly the same size as Nizhegorodoblgaz and Voronezhoblgaz. Besides having similar revenues and assets, the three companies also have similarly large investments going into their regions. Also, all three companies have shown rapid growth in financials in 2006, due almost entirely to increases in the "investment surcharge."

• Rostovoblgaz' financials have been improving in the last few years, due to gasification in the region and an increasing transport rate.

Rostovoblgaz financials, $ mn

	2004	2005	2006E
Sales	20	45.4	59.2
EBITDA	2.5	4.5	9.5
Net profit	0.7	0.8	3.4
EBITDA margin, %	13%	10%	16%
Net margin, %	4%	2%	6%

Source: Company data, Sovlink estimates

Rostovoblgaz' 1H06 dynamics also look impressive.

Rostovoblgaz 1H06 results, $ mn

	1H05	1H06	% chg.
Sales	23.5	34.2	46%
EBITDA	3.2	7.6	138%
Net profit	0.88	6	582%
EBITDA margin, %	14%	22%	8 ppt
Net margin, %	4%	18%	14 ppt

Source: Company data

Investment program

• The situation with gasification in the Rostov district reached a turning point in 2006, when the Rostov district administration signed a plan for gasification in 2006 with Gazprom. The monopoly's investments in the creation of a gas network will be about $20 mn in 2006, up from only $2 mn two years ago. The Rostov region administration is planning to spend more then $44 mn this year, versus $35 mn in total over the last three years.

• From 2006, the Rostov region started a new scheme of financing the expansion of gas distribution systems. The district budget will provide for development by giving credit to Rostovoblgaz at 1/3 of the refinancing rate from 2007.

• The problem of ownership of gas distribution networks is being solved in a new way. Previously, gas distribution networks were built with budget money and were government property. The regional administration then leased the property to gas distribution companies or sold it to leasing firms. Oblgazes had to include leasing payments in their tariffs. The new scheme allows oblgazes to finance gas network acquisitions without tariff increases/surcharges.

• The shareholder structure holders of Rostovoblgaz is similar to other gas distribution companies: 51% is owned by Gazprom, 25.5% by the RFFI, while the remainder is freefloat.

VALUATION

Comparative method

	P/S	EV/A	P/E	EV/EBITDA
Nearest international peers	1.7	1.0	19.0	7.8
		2006E		
Rostovoblgaz	Sales, $mn	Assets, $ mn	Net profit, $mn	EBITDA, $mn
	59.2	96.0	3.4	9.5
Estimated M.Cap, $ mn	101.3	98.9	64.1	73.8
Weight	25%	25%	25%	25%
Average weighted fair capitalization, $ mn				**84.5**
Fair value, $				**702.8**

Source: Company data, Sovlink estimates

DCF model, $ mn

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Volume of gas transportation, bn m^3	6.65	6.7	6.8	6.8	6.9	6.9	6.9	6.9	6.9	6.9	6.9
Tariff, rubles	130.0	169.0	187.6	208.2	231.1	256.6	284.8	316.1	350.9	389.5	432.3
Revenue from gas transportation	31.4	42.3	49.1	54.5	61.3	68.1	75.6	83.9	93.1	103.4	114.7
Revenue from LPG sales	7.2	8.5	9.7	11.1	12.6	14.4	16.4	18.7	21.3	24.3	27.7
Revenue from technical services	6.7	8.4	9.4	10.5	11.8	13.2	14.8	16.6	18.6	20.8	23.3
Revenues	45.4	59.2	68.2	76.1	85.8	95.7	106.8	119.2	133.0	148.5	165.7
COGS	39.1	49.1	56.6	63.9	71.2	79.4	88.6	98.9	110.4	123.2	137.5
Gross profit	6.4	10.1	11.6	12.2	14.6	16.3	18.2	20.3	22.6	25.2	28.2
Gross margin, %	14.0%	17.0%	17.0%	16.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
Amortization	2.7	3.6	4.1	5.3	6.0	6.7	7.5	8.3	9.3	10.4	11.6
Cashflow of non-operating activities	4.6	4.1	3.4	3.8	4.3	4.8	5.3	6.0	6.6	7.4	8.3
EBITDA	4.5	9.5	12.3	13.7	16.3	18.2	20.3	22.6	25.3	28.2	31.5
EBITDA margin, %	9.9%	16.0%	18.0%	18.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Interest payments	0.3	0.3	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.5	1.7
Amortization	2.724	3.55	4.09	5.32	6.00	6.70	7.47	8.34	9.31	10.39	11.60
EBT	1.49	5.62	7.50	7.61	9.43	10.53	11.75	13.11	14.63	16.33	18.23
Net profit	0.8	3.4	5.2	5.8	7.2	8.0	8.9	10.0	11.1	12.4	13.9
Net margin, %	1.7%	5.7%	7.7%	7.6%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%

Source: Company data, Sovlink estimates

DCF model, $ mn (continued)

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	45.4	59.2	68.2	76.1	85.8	95.7	106.8	119.2	133.0	148.5	165.7
Gross profit	6.4	10.1	11.6	12.2	14.6	16.3	18.2	20.3	22.6	25.2	28.2
Non-COGS	4.6	4.1	3.4	3.8	4.3	4.8	5.3	6.0	6.6	7.4	8.3
EBITDA	4.5	9.5	12.3	13.7	16.3	18.2	20.3	22.6	25.3	28.2	31.5
Amortization & depreciation	2.7	3.6	4.1	5.3	6.0	6.7	7.5	8.3	9.3	10.4	11.6
EBIT	1.8	5.9	8.2	8.4	10.3	11.5	12.8	14.3	16.0	17.8	19.9
interest payments	0.3	0.3	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.5	1.7
Net profit	0.8	3.4	5.2	5.8	7.2	8.0	8.9	10.0	11.1	12.4	13.9
EBITDA margin, %	9.9%	16.0%	18.0%	18.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net margin, %	1.7%	5.7%	7.7%	7.6%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%
Net profit	0.8	3.4	5.2	5.8	7.2	8.0	8.9	10.0	11.1	12.4	13.9
Amortization & depreciation	2.7	3.6	4.1	5.3	6.0	6.7	7.5	8.3	9.3	10.4	11.6
Capex	2.4	2.5	2.5	2.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0
FCFF	1.1	4.4	6.8	8.6	11.2	12.7	14.4	16.3	18.4	20.8	23.5
FCFF discounted		3.7	4.9	5.2	5.8	5.6	5.3	5.1	4.9	4.7	4.5

Source: Sovlink estimates

WACC	16%
Terminal growth rate	3%
NPV of forecasted years	49.74
NPV of terminal value	35.5
Fair EV, $ mn	85.2
Net debt, $ mn	14
Fair M.Cap, $ mn	71.2
Fair value, $	592

Source: Sovlink estimates

Price target derivation

Comparative valuation	703
DCF valuation	592
Average	**648**

Source: Sovlink estimates

Our valuation suggests a fair price of $648 per ordinary share, implying 67% growth from current levels. Applying a discount of 30% to the ordinary shares—in line with what the market currently uses—we arrive at a fair value of $454 per preferred share, suggesting 60% potential growth.

Tel.: +7 495 967 1300
Fax : +7 495 967 1311

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