



Elektrogaz

Company
Note

BUY

Upside: 49%

Target Price: US\$892

Analyst:

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Under Gazprom's protection

STOCK DATA

Ticker	elgz	MCap (US\$ mn)	39
Shares Ords	57,814	Free Float, %	49
Shares Pref	19,272	Free Float (US\$ mn)	16

PERFORMANCE

	2004	2005	2006E
Sales, \$ mn	56	64.1	75.7
EBITDA, \$ mn	4.1	4.3	5.4
Net profit, \$ mn	1.6	1.3	1.8
EBITDA margin, %	7.4%	6.8%	7.2%
Net margin, %	2.9%	2.0%	2.4%

COMPARATIVE MULTIPLES, 2006E

	P/S	EV/ EBITDA	P/E
Russian peers	0.5	10.8	17.0
Global peers	1.1	10.6	32.1
Elektrogaz	0.5	7	21

Note: Given the large bid-ask spread in Elektrogaz shares, we base our valuations for the company on a price of \$600 per share, the price of the last OTC trade.

ELEKTROGAZ VALUATION

- Elektrogaz is a Gazprom subsidiary that specializes in the construction, assembly and service of the gas monopoly's electricity infrastructure at its extraction points and pipelines. The investment case for the company is highlighted by the expected rapid growth in Gazprom's orders for electricity networks and the assembly of power supply equipment. Elektrogaz is Gazprom's largest service subsidiary working in electricity infrastructure.

- Gazprom's strategy for adding new electrical capacity envisages 40% growth in the next two years. As a result, the company's electricity production should increase from 1.8 bn kWh in 2005 to 2.5 bn kWh in 2007.

- In order to ensure its gas export commitments, Gazprom has to invest about \$11–12 bn per year in gas production. The development of new gas fields is connected with the creation of new electricity infrastructure. We expect that Gazprom's own electrical capacity and networks may increase by several times through 2010.

- Between 2003–05, Elektrogaz' revenues increased by 73% to \$64 mn. we believe that by revenues will increase another 70% by 2008, to \$109 mn, due to the expected growth of Gazprom's orders.

- Elektrogaz is demonstrating rapid growth. Over the last five years, the company's revenues have more than tripled, while their annual growth rate was 27%.

- Gas industry service companies have been one the best-performing investment ideas of the last few months in Russian second-tier stocks. Interest in service companies is explained, first, by expectations of order book growth in connection with forthcoming gas industry reform and subsequent huge investments in the Russian gas industry. Second, the beginning of asset consolidation in separate gas segments (exploration, transportation, service) increases the investment value of gas service companies.

- We value Elektrogaz shares via a DCF model and comparative multiples. As a result, we come to a fair value of \$892 per ordinary share, implying 49% upside. We rate the company a **BUY**.



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

November 28, 2006

Comparative valuation	899
DCF valuation	885
Average	892

Source: Sovlink estimates

Company description

- Elektrogaz is a Gazprom subsidiary providing a wide range of services connected to the power supply of gas units, from equipment setup and operation to electricity and heat network roll-outs.
- Elektrogaz provides electricity supply support for Gazprom's gas production and transport units. On the one hand, Gazprom is the only buyer of Elektrogaz' services—as much as 96% of the company's revenues come from Gazprom and its enterprises. On the other hand, Elektrogaz has a strong position, as it is the

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largest Gazprom subsidiary providing electricity infrastructure setup services. In addition to Elektrogaz, the only other Gazprom-owned company working in the sector is Gazpromenergосervice—a 100% subsidiary of Gazprom which renders power transmission line setup and operating services. However, these companies are not competitors, as they work in different geographic areas.

Gazprom's electroservice enterprises

Name	Ownership structure	Gazprom's share	Revenues 2005, \$ mn
Elektrogaz	Public	51%	64
Gazpromenergосervice	LLC	100%	38

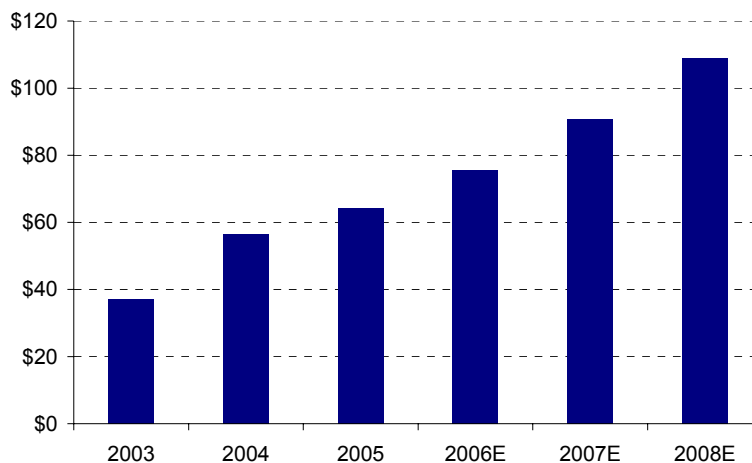
Source: Gazprom

- We believe the probability of Gazprom consolidating electroservice companies such as Elektrogaz and Gazpromenergосervice is high, as we think that consolidation of subsidiaries by business lines is a logical step in the gas market reformation/liberalization process. In this case, Gazprom's goal is to increase its share in Elektrogaz capital as much as possible. At the moment, Gazprom's share in Elektrogaz' capital is 51%.

- Even though Gazprom is outsourcing part of its electricity network construction work at the present time, in 2006–08 we expect that Elektrogaz could nearly double its order book due to its extensive branch network. Elektrogaz has 12 branches, setup according to Gazprom's needs. The largest branches are in Krasnodar, Moscow, Novy Urengoi and Nadym.

- Elektrogaz is developing rapidly. Between 2003–05 the company's sales increased 73% to \$64 mn. We expect that the company's revenues will increase another 70% by 2008 to \$109 mn, due to an anticipated increase in Gazprom's orders.

Elektrogaz revenue dynamics, \$ mn

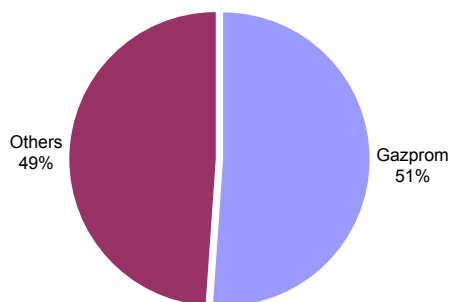


Source: Company data, Sovlink estimates

Elektrogaz' current projects

- The electrotechnical infrastructure fit-out for Gazprom's Zapolyarnoe, Yamburgskoe and Yamalskoe fields;
- The electrotechnical infrastructure fit-out for the Yamal-Europe and Blue Stream gas pipelines.

Elektrogaz shareholder structure



Source: Company data

•Gazprom currently owns a controlling stake in Elektrogaz. Other shareholders are unknown; however, we feel there is high probability that 35%–40% is owned by private individuals, including Elektrogaz management.

Investment case

• Elektrogaz provides development and operational services to Gazprom's electric power units. At the end of October, Gazprom announced an ambitious investment program. According to this program, it plans to spend \$11 bn per year on gas field exploration through 2010. Gas field exploration is directly connected to the development of surface facilities, including electrical energy. As a result, Elektrogaz' order book could increase by several times in the next few years.

• We have no doubt that Gazprom will increase its participation in the electricity sector. In addition to buying stakes in electricity assets such as Mosenergo, OGK-5, etc., Gazprom plans to build its own capacities. Gazprom's electricity production will increase from 1.8 bn kWh to 2.5 bn kWh in the next two years. Gazprom will build its own electricity capacities in order to decrease energy supply risks and increase its independence from UES' facilities. This is a very important issue for Gazprom, as seen when UES stopped supplying some of Gazprom's gas production objects in 2006¹, as severe winter temperatures forced UES to supply extra electricity to residential customers, and restrict/cut off industrial customers in the process. Elektrogaz is the only branch of Gazprom specializing in building electricity infrastructure, which is why the company is the direct beneficiary from this situation.

¹ For example, UES temporarily stopped supplying electricity to some of Noyabrskneftegaz' fields in January 2006, due to problems at Tyumenenergo's network. As a result, some of the company's oil wells experienced problems.



Valuation

- We estimate the fair value of Elektrogaz shares via a DCF model as well as by comparing the company to Russian and international peers.

Comparison to Russian companies

- We compared Elektrogaz to two Russian peers—Sevzapelektrosetstroi and Lengazspetsstroi. Sevzapelektrosetstroi specializes in building electricity networks, while Lengazspetsstroi builds gas infrastructure objects. On the one hand, Elektrogaz builds and services electricity and heat networks at gas production and refining units, which is why we feel the company's nearest peer is Sevzapelektrosetstroi. On the other hand, Elektrogaz is a Gazprom service company, therefore we feel that comparing with another service company—Lengazspetsstroi—is appropriate.

Top-line comparison, 2006E, \$ mn

	Sales	EBITDA	NI	Assets
Sevzapelektrosetstroi	340	16	9	120
Lengazspetsstroi	804	34	27	398
Elektrogaz	76	5	2	41

Note: Estimates for Sevzapelektrosetstroi and Lengazspetsstroi come from annualizing the companies' 1H06 results.

Source: Sovlink estimates

Valuation comparison, 2006E

	P/S	EV/EBITDA	P/E	P/A
Sevzapelektrosetstroi	0.6	12.3	22.3	1.7
Lengazspetsstroi	0.4	9.2	11.6	0.8
Average	0.5	10.8	17.0	1.2

Source: Sovlink estimates

Elektrogaz comparative valuation results

	Sales	EBITDA	NI	Assets
2006E results, \$mn	76	6	2	41
M.cap estimate, \$ mn	37.0	58.8	30.2	50.4
Weights	25%	25%	25%	25%
Average Mcap, \$ mn				44
Fair value, ordinary, \$				618

Source: Sovlink estimates



International valuations

Company	Country	P/S	EV/EBITDA	P/E	P/A
Emcor Group Inc	US	0.41	8.99	32.22	1,09
Jacobs Engineering Group Inc	US	0.87	13.08	32.58	2,09
Englobal Corp	US	0.79	21.73	38.66	2,43
Sys	US	0.96	7.59	31.10	1,77
Abb Ltd Reg	Switzerland	1.93	9.18	51.00	1,94
Arcadis NV	Netherlands	0.68	7.98	20.39	1,10
Prinsiptek Corporation BHD	Malaysia	1.26	7.64	18.64	0,89
Lindea AG	Germany	1.04	6.33	19.69	0,83
SNC-Lavalin Group	Canada	1.54	13.22	44.96	1,39
Average		1.05	10.64	32.14	1.50

Source: Bloomberg, Factiva, Reuters

International valuation comparison

	P/S	EV/EBITDA	P/E	P/A
Peer group average	1.05	10.64	32.14	1.50
2006E				
	Sales, \$mn	EBITDA, \$mn	Net income, \$mn	Assets, \$ mn
Elektrogaz	76	5	2	41
M.Cap estimate, \$ mn	80	58	57	62
Weights	25%	25%	25%	25%
Average weighted M.Cap, \$ mn				64,1
Fair value, ordinary, \$				899.2

Source: Bloomberg, Sovlink



DCF valuation

• We use flat analysis to forecast revenue growth. We expect revenues to increase at roughly 20% a year through 2008—due to expected contracts signed with Gazprom—10% from 2008–20, and then 4% a year. We see this as conservative, as the company's average revenue growth rate was 27% a year in 2001–05.

DCF model, \$ mn

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Contractor's work	58.6	69.1	83.0	99.6	114.5	131.7	144.9	159.3	175.3	192.8	212.1
Other	5.5	6.5	7.8	9.3	11.0	13.1	15.0	17.1	19.4	22.2	25.3
Revenues	64.1	75.7	90.8	108.8	125.5	144.8	159.8	176.4	194.7	215.0	237.4
COGS	39.4	46.9	55.5	66.6	76.8	88.6	97.7	107.9	119.1	131.5	145.1
Gross profit	24.7	28.8	35.3	42.3	48.8	56.3	62.1	68.5	75.6	83.5	92.2
Gross margin, %	39%	38%	39%	39%	39%	39%	39%	39%	39%	39%	39%
Amortization	0.8	1.5	1.8	2.2	2.5	2.9	3.2	3.5	3.9	4.3	4.7
Management expenses	18.4	21.2	24.5	29.4	33.9	39.1	43.2	47.6	52.6	58.0	64.1
Cashflow of non-operating activities	2.7	3.6	4.4	5.2	6.0	7.0	7.7	8.5	9.3	10.3	11.4
EBITDA	4.3	5.4	8.2	9.9	11.4	13.1	14.5	16.0	17.6	19.5	21.5
EBITDA margin, %	6.8%	7.2%	9.0%	9.1%	9.1%	9.1%	9.0%	9.0%	9.1%	9.1%	9.1%
Interest payments	0.15	0.38	0.45	0.54	0.63	0.72	0.80	0.88	0.97	1.07	1.19
Amortization	0.8	1.5	1.8	2.2	2.5	2.9	3.2	3.5	3.9	4.3	4.7
EBT	3.4	3.6	5.9	7.1	8.2	9.5	10.5	11.6	12.8	14.1	15.5
Net profit	1.3	1.8	3.6	4.3	6.1	7.0	7.7	8.5	9.4	10.4	11.5
Net margin, %	2.0%	2.4%	3.9%	3.9%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%

Source: Sovlink estimations

DCF model, \$ mn (continued)

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	64.10	75.69	90.77	108.84	125.54	144.81	159.82	176.40	194.72	214.97	237.35
Gross profit	24.68	28.76	35.26	42.28	48.77	56.26	62.09	68.53	75.65	83.52	92.21
Non-COGS	2.70	3.63	4.36	5.22	6.03	6.95	7.67	8.47	9.35	10.32	11.39
EBITDA	4.35	5.45	8.21	9.85	11.36	13.11	14.46	15.96	17.62	19.45	21.48
Amortization & depreciation	0.77	1.51	1.82	2.18	2.51	2.90	3.20	3.53	3.89	4.30	4.75
EBIT	3.58	3.94	6.40	7.67	8.85	10.21	11.27	12.44	13.73	15.16	16.73
Interest payments	0.15	0.38	0.45	0.54	0.63	0.72	0.80	0.88	0.97	1.07	1.19
Net profit	1.30	1.78	3.57	4.28	6.08	7.02	7.75	8.55	9.44	10.42	11.50
EBITDA margin, %	6.8%	7.2%	9.0%	9.1%	9.1%	9.1%	9.0%	9.0%	9.1%	9.1%	9.1%
Net margin, %	2.0%	2.4%	3.9%	3.9%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%
Net profit	1.30	1.78	3.57	4.28	6.08	7.02	7.75	8.55	9.44	10.42	11.50
Amortization & depreciation	0.77	1.51	1.82	2.18	2.51	2.90	3.20	3.53	3.89	4.30	4.75
Capex	1.89	2.24	2.31	2.31	2.31	2.31	2.31	2.31	2.31	2.31	2.31
FCFF	0.18	1.05	3.07	4.15	6.29	7.61	8.63	9.77	11.02	12.41	13.94
FCFF discounted		0.92	2.32	2.73	3.60	3.78	3.73	3.67	3.60	3.53	3.45

Source: Sovlink estimations



WACC	15%
Terminal growth rate	4%
NPV of forecasted years	31.33
NPV of terminal value	32.6
Fair EV, US\$ mn	63.9
Net Debt, US\$ mn	0.8
Fair MCAP, US\$ mn	63.1
Fair value, ordinary, \$	885.17

Source: Sovlink estimations

Price target derivation, \$

Comparative valuation	899
DCF valuation	885
Average	892

Source: Sovlink estimations

Using the average of our fair value estimates, we arrive at a target price of \$892 per ordinary share of Elektrogaz, implying 49% upside. We rate the company a **BUY**.



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

November 28, 2006

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

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