

**Regional natural gas distributors****Flash  
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**Nizhegorodoblغاز: BUY****UPSIDE: 53%****Target Price: US\$4.9****PERFORMANCE 2006E**

Revenue (US\$ mn)	65.5	P/S	1.4
EBITDA(US\$ mn)	20.2	EV/EBITDA	4.5
Net Income (US\$ mn)	15.6	P/E	6.0

**Voronezhoblغاز: BUY****UPSIDE: 87%****Target Price: US\$4.2****PERFORMANCE 2006E**

Revenue (US\$ mn)	50.9	P/S	0.9
EBITDA(US\$ mn)	10.7	EV/EBITDA	4.3
Net Income (US\$ mn)	5.8	P/E	8.3

**Rostovoblغاز: BUY****UPSIDE: 55%****Target Price: US\$648****PERFORMANCE 2006E**

Revenue (US\$ mn)	59.2	P/S	0.9
EBITDA(US\$ mn)	9.5	EV/EBITDA	6.7
Net Income (US\$ mn)	6.1	P/E	8.7

**Valuation comparison**

	P/S	P/BV	P/E	EV/ EBITDA
<b>Obligases</b>	<b>1.0</b>	<b>1.3</b>	<b>8.6</b>	<b>5.2</b>
Closest 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
<b>Average</b>	<b>1.7</b>	<b>2.3</b>	<b>19.0</b>	<b>7.8</b>
Discount to global peers, including a 30% discount for non-transparency	46%	52%	85%	36%

Source: Bloomberg, Sovlink estimates

**Gazprom coming closer to control?**

• Today *Vedomosti* reported that the government intends to swap its stakes in 79 Russian regional natural gas distributors (obligases) in exchange for Gazprom shares, which currently belong to the obligases. The article supports one of the investment theses we discussed in our report (“Regional natural gas distributors: The potential of the last mile” of November 22, 2006) – that Gazprom will try to obtain control of the whole gas distribution system in Russia and make it more efficient. Gazprom has already consolidated a controlling stake in most of the obligases. Gazprom currently controls 197 gas distribution companies (including obligases, gorgases and kraigases) through its subsidiary Gazpromregiongaz, with a blocking stake being owned by the Federal Property Fund (RFFI). The remaining shares are held by individuals or traded on the stock market. The article mentions that the RFFI has already decided, in principle, to sell its stakes in the obligases to Gazprom. We note that the mechanism that will be used to transfer shares from RFFI to Gazprom is still unclear. In our opinion, the transfer of shares could occur in two fundamentally different ways: either RFFI shares could be exchanged for Gazprom shares belonging to the regional gas distributors, or the RFFI shares could be sold for cash in open auctions.

• We estimate that obligases altogether own up to 1% of Gazprom’s shares. In case of an exchange of shares, these shares will be exchanged for RFFI’s stakes in the obligases. We believe that this method would be quite difficult to implement, because of the lack of transparency in the ownership structure of the obligases’ stakes in Gazprom, and also due to the potential difficulties in evaluating the obligases’ stake in the swap. We believe it would be easier both for Gazprom and RFFI to transfer these shares by selling them directly to Gazprom through open auctions. If this happens, it could lead to the whole sector being reassessed.

• Regardless of the method that is chosen, the comments of Mezhrefiongaz officials in the article do not leave any doubts of Gazprom’s intentions to consolidate the obligases. Just as the regiongases are now being consolidated by Mezhrefiongaz, the obligases will also be consolidated within a holding structure. We believe that after acquiring the government’s stakes in the obligases, Gazprom will start buying shares in the open market. We stress that the expected acquisition of the obligases by Gazprom remains a speculative idea.

• We cover three obligases: Nizhegorodoblغاز (nnog), Voronezhoblغاز (vogz), and Rostovoblغاز (rtbg). Our price targets suggest upsides of 53%, 87% and 55%, respectively, to the companies’ current mid-market prices. We reiterate our **BUY** recommendations on all three companies.



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## STOCK RATING POLICY

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

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