

## **Investment idea for Oblegazes**

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For the state to obtain a direct controlling stake in Gazprom (50% + 1 share), it has to transfer a 0.89% in Gazprom from its affiliates to the state-run Rosneft. After a protracted period of discussions, a decision has finally been taken on this initiative, involving a multistep asset swap transaction between the state and Gazprom in 2Q08.

The deal will include Gazprom's subsidiaries, including its distributors (regional gas companies). Today, INTERFAX reported that the valuation of the distributors by the Federal Property Management Agency with respect to the swap transaction differs significantly from the current market value of the companies.

Given the low liquidity of the distributors, we cannot fully rely on speculative trading prices. However, the share swap may result in an obligation on Gazprom to make an offer to the distributors' minority shareholders. In this case, the repurchase price is likely to be equal to the price estimated by the Federal Property Management Agency. Those companies, whose estimated price is higher than the current ask price, will be able to sell at a profit.

### **Deal structure**

The essence of the deal lies in the state's intention to directly acquire a controlling stake in Gazprom (50% + 1 share), rather than through its affiliates.

In our opinion, the structure for acquiring Gazprom's shares appears as shown in Appendix 1. The state conducts an SPO in Rosneftgaz, which holds stakes in Rosneft and Gazprom and is 100% state-owned by the state via the Federal Property Management Agency. The state will pay for the SPO using its stakes in Rosgazifikatsia (72.5%), 70 gas distributing companies, Kamchetskgazprom, Daltransgaz, as well as in other companies.

Simultaneously, Gazprom will repurchase its shares in Rosgazifikatsia (about 0.89%) at the market value. At the moment, we do not know the exact price, which Gazprom will pay for these shares. However, we expect the price will range between \$2.5 bn to \$2.8 bn.

After repurchasing its shares in Rosgazifikatsia, Gazprom (through one of its subsidiaries) will swap (or sell and purchase) them into the distributors' blocks and other companies (stated above) held by Rosneftegaz. Thus, the state will obtain direct control over Gazprom, and Gazprom will complete the consolidation of its distributors.

## Valuation of distributors

Based on the Federal Property Management Agency's valuation of the distributors, we have made recommendations on all distribution companies trading on the RTS Board (refer to Appendix 2). The table shows that the Agency's valuation significant differs from their current market values.

We note that companies such as Stavropolkraygaz, Krasnodarkraygaz and Nizhegorodoblغاز are amongst the most negatively valued (in relation to their current market value). Interestingly, to date, investors had been viewing Nizhegorodoblغاز as an investment target, given its very positive performance, high returns, gasification level, gas flows and asset value. They also rated highly the company's management, considering it as the most effective management team in the industry. However, the company was only valued at 40% of its current market price (according to RTS Boards trades).

Stavropolkraygaz was valued at only 8% of its current capitalization.

Companies such as Saratovoblغاز, Smolenskoblغاز, Tulaoblغاز and Ivanovooblغاز are amongst the most positively valued (in relation to their current market value). For instance, Ivanovooblغاز was valued 25 times higher than its market value based on its bid price. Thus, the valuation of most of the distributors on the RTS Board turned out to be positive for investors. Unfortunately, these companies have low liquidity, which is why it is extremely difficult to purchase their shares even at the ask price. Nevertheless, we expect that investors who already hold these shares in their portfolios will be able to make use of the offer which Gazprom is expected to make in 3Q08.

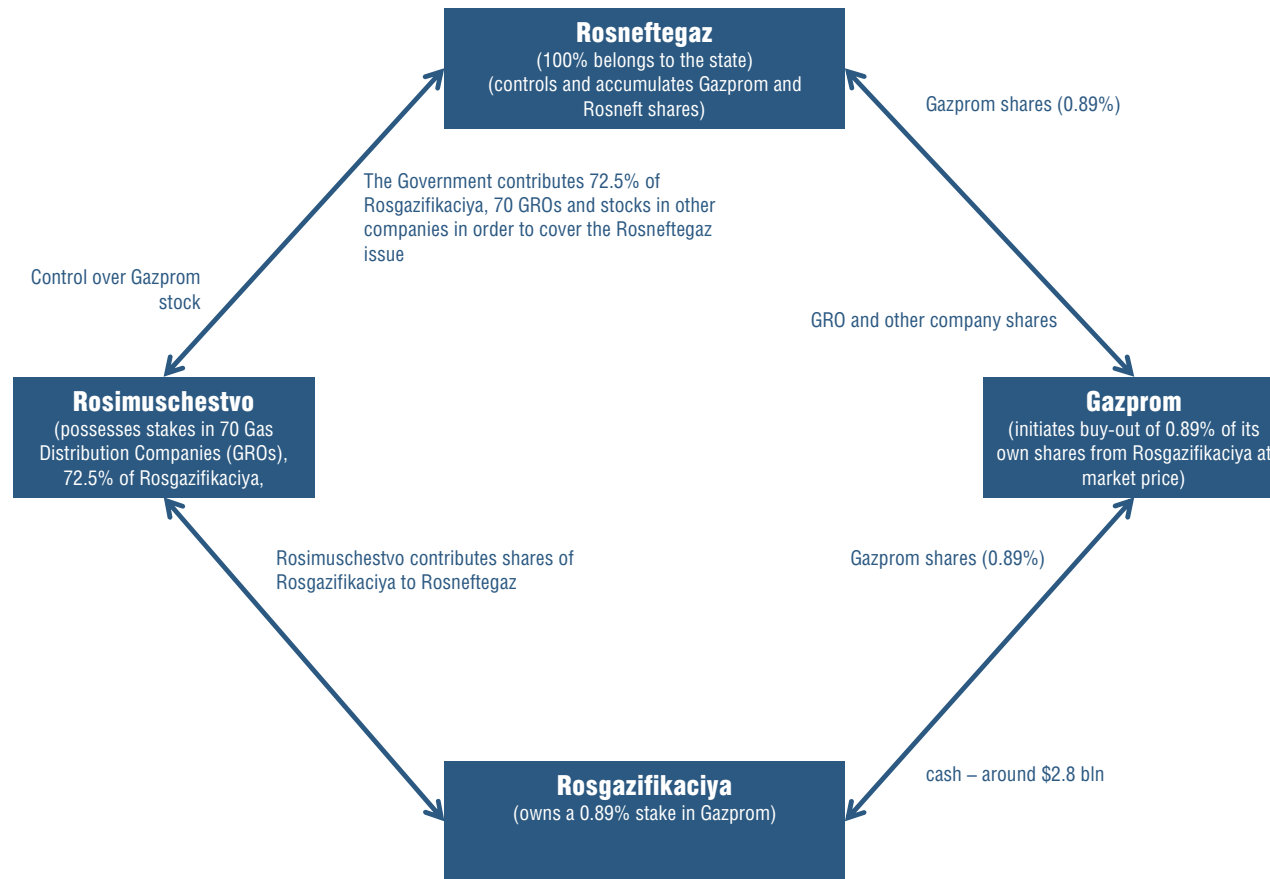
## Simultaneous consolidation

Another process of consolidation of gas distribution companies is taking place within another energy holding - Integrated Energy Systems. As opposed to other investors interested in energy assets, IES is a fully-fledged energy company. This means that it is interested in both heat generation and gas supplies to its power stations and to consumers, and gas transportation. IES Holding is one of the largest investors (after Gazprom) in gas distributors.

We assume IES will be interested in purchasing low and medium pressure grids and stakes in gas distributing companies. Regiongazfinans may act as a potential buyer of such assets. It is run by a closed-end unit investment fund and a closed-end unit real estate fund. The two funds accumulate stakes in regional gas companies and low pressure grids. IES is likely to firstly increase its stakes in the distributors which are located in the same regions as its energy assets. In this case, the company may also face an obligation to make an offer to minority shareholders.

At the same time, we cannot rule out its interest in other regions, which will eventually support the energy market.

Appendix 1





## Appendix 2

#	Company	Ticker	Region	Privatized share (%)	Share Valuation (RUR mln)	Mcap * (RUR mln)	Mcap (US\$ mln)	Number of ordinary shares	Price ** (US \$)	Bid (US \$)	Ask (US \$)	Recommendation	Upside
1	Altaykraygazservice	akgs	Barnaul, Altai Territory	25.50%	230	902	38.38	113 317	338.71	105.00	250.00	BUY	35.48%
2	Astrakhanoblgaz	asog	Astrakhan	25.50%	56	220	9.35	3 929 700	2.38	2.00	6.00		-60.37%
3	Belgorodoblgaz	bogz	Belgorod	25.50%	1 600	6 275	267.00	80 310	3 324.62	300.00	700.00	BUY	374.95%
4	Bryanskoblgaz	brog	Bryansk	25.50%	750	2 941	125.16	109 935	1 138.46	390.00	425.00	BUY	167.87%
5	Vladimiroblgas	vlog	Vladimir	21.39%	220	1 029	43.77	45 043	971.67	1 000.00	2 000.00		-51.42%
6	Volgogradoblgaz	vlgz	Volgograd	25.50%	680	2 667	113.48	85 551	1 326.40	491.00	805.00	BUY	64.77%
7	Voronezhoblgaz	vogz	Voronezh	25.50%	1 700	6 667	283.69	22 173 400	12.79	3.60	3.95	BUY	223.90%
8	Ivanovooblgaz	ivog	Ivanovo	25.50%	280	1 098	46.73	310 590	150.44	5.60	n/a	BUY	2586.42%
9	Irkutskoblgaz	irog	Irkutsk	24.50%	n/a	n/a	n/a	n/a	n/a	140.00	250.00		n/a
10	Kalugaoblgaz	klog	Kaluga	25.50%	230	902	38.38	29 887	1 284.21	460.00	900.00	BUY	42.69%
11	Karelgaz	klgz	Republic of Karelia	25.50%	53	208	8.84	27 333	323.58	55.00	199.00	BUY	62.60%
12	Kirovoblgaz	krog	Kirov	25.50%	420	1 647	70.09	99 591	703.75	135.00	300.00	BUY	134.58%
13	Krasnodarkraygas	kgas	Krasnodar Territory	25.50%	150	588	25.03	2 070 675	12.09	7.00	70.00		-82.73%
14	Kostromaoblgaz	koog	Kostroma	25.50%	310	1 216	51.73	55 402	933.74	335.00	570.00	BUY	63.81%
15	Kurganoblgaz	kuog	Kurgan	25.50%	n/a	n/a	n/a	n/a	n/a				n/a
16	Kurskgaz	krgz	Kursk	56.98%	1 400	2 457	104.55	88 420	1 182.46	250.00	460.00	BUY	157.06%
17	Lenoblgaz	leog	Leningrad	32.30%	430	1 331	56.65	79 096	716.22	710.00	4 500.00		-84.08%
18	Lipetskoblgaz	lpog	Lipetsk	25.50%	510	2 000	85.11	118 988	715.25	130.00	n/a	BUY	450.19%
19	Omskoblgaz	omog	Omsk	70.84%	460	649	27.63	1 375 875	20.08	7.00	10.00	BUY	100.83%
20	Nizhegorodoblgaz	nnog	Nizhni Novgorod	25.50%	310	1 216	51.73	27 778 800	1.86	4.25	4.50		-58.62%
21	Oreloblgaz	orgz	Orel	32.91%	150	456	19.40	37 949	511.09	250.00	500.00		2.22%
22	Orenburgoblgaz	orog	Orenburg	35.00%	1 800	5 143	218.84	76 795	2 849.73	1 200.00	1 350.00	BUY	111.09%
23	Penzagazifikatsiya	pgzf	Penza	25.50%	180	706	30.04	34 620	867.64	130.00	200.00	BUY	333.82%
24	Rostovoblgaz	rtbg	Rostov	25.50%	1 100	4 314	183.56	120 246	1 526.56	500.00	660.00	BUY	131.30%
25	Ryazanoblgaz	rzog	Ryazan	25.50%	170	667	28.37	4 802 110	5.91	7.30	13.00		-54.56%
26	Samaragaz	sagz	Samara	25.50%	200	784	33.38	115 396	289.22	45.00	98.00	BUY	195.12%
27	Saratovoblgaz	srog	Saratov	25.50%	1 100	4 314	183.56	3 678 100	49.91	7.00	8.00	BUY	523.84%
28	Sibirgasservice	sbgs	Novosibirsk	25.50%	n/a	n/a	n/a	n/a	n/a				n/a
29	Stavropolkraygaz	stkg	Stavropol Territoty	24.40%	52	213	9.07	111 389	81.41	575.00	1 100.00		-92.60%
30	Smolenskoblgaz	smog	Smolensk	15.94%	510	3 199	136.15	401 416	339.17	81.00	100.00	BUY	239.17%
31	Tambovoblgaz	tozg	Tambov	25.50%	420	1 647	70.09	864 020	81.12	30.00	40.00	BUY	102.80%
32	Tveroblgaz	tveo	Tver	22.70%	310	1 366	58.11	178 468	325.62	233.00	350.00		-6.97%
33	Tulaoblgaz	tuog	Tula	34.03%	1 400	4 114	175.06	158 591	1 103.87	210.00	250.00	BUY	341.55%
34	Chitaoblgaz	chog	Chita	25.50%	n/a	n/a	n/a	n/a	n/a				n/a
35	Yaroslavl oblgaz	yrog	Yaroslavl	25.50%	210	824	35.04	69 706	502.74	240.00	300.00	BUY	67.58%

\* expected market capitalization based on the valuation prepared by Rosimuschestvo for the stake to be privatized

\*\* expected price per ordinary share according to the valuation of the stake to be privatized

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