



Regional natural gas distributors

On the way to consolidation

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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: 95%****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
Oblغازes	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%

• On February 28, Gazprom's Board of Directors announced a series of decisions, which directly affect the regional natural gas distributors (oblgazes).

• Firstly, the Board of Directors approved LLC Mezhregiongaz's acquisition of additional stakes in 17 Russian regional gas companies (regiongazes). According to Gazprom, "maintaining control at each level of the gas distribution network is crucial for the security of Russia's energy supplies".

• We think that these transactions illustrate the thesis of our previous research ("Regional natural gas distributors: the potential of the last mile" November 22, 2006); namely, that Gazprom will try to obtain control of the whole gas distribution system in Russia and make it more efficient. We would like to note that controlling the regiongazes and oblgazes is important both for ensuring investments in gas pipelines as well as for political reasons. As the gas distribution market (especially the oblgazes) in Russia remains rather fragmented, we believe that the consolidation of gas distribution assets is essential for the reform and liberalization of the gas market. Just as the regiongazes are now being consolidated by Mezhregiongaz, Russian oblgazes will also be consolidated within a holding structure; for example, Regiongazholding. Furthermore, Gazprom will be interested in acquiring at least 75% of the oblgazes, whereas, currently, Gazprom's average stake in them is about 55%. We stress that the expected acquisition of the oblgazes by Gazprom remains a speculative idea for them. Gazprom's fundamental idea is that they are not fairly valued today.

• The second important decision announced by Gazprom's Board of Directors concerned the possible revision of the principles on which transportation tariffs are established. Currently, gas transportation tariffs are established by the Russian Tariff Agency based on a "cost plus mechanism". At present, a number of oblgazes receive so-called "investment surcharges" on top of the tariff charges, which allows them to finance the acquisition of existing low-pressure pipelines from the regional authorities and to build new ones. Because of this "investment surcharge", we expect the increase in the gas transportation tariff to exceed the annual gas price growth for the next few years.

• We actively cover three oblgazes: Nizhegorodoblغاز (NNOG), Voronezhoblغاز (VOGZ), and Rostovoblغاز (RTBG). Our price targets suggest upside of 53%, 95% and 55%, respectively, to the companies' current mid-market prices. We reiterate our BUY ratings on all three companies.



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YOUR FIRST CALL – FOR THE SECOND TIER

March 05, 2007

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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