

## Novatek's Q3 and 9M 2011 results: strong as usual

Novatek (NOTKRM, Baa3/BBB-/BBB-) announced its Q3 and 9M 2011 financials on Friday. These again held no surprises and displayed strong credit metrics. Novatek's revenues surged by 51% yoy to RUB 125 bn in 9M 2011, while net profit jumped by 47% yoy to RUB 42 bn. The EBITDA margin held at impressive 50% in 9M 2011 – up by 400bp on 9M 2010. This robust performance was driven by higher gas prices and volumes sold, as well as additional output from recently acquired assets. In Q3 the group's total natural gas production leapt by 46% yoy and its liquids output advanced by 16% yoy.

According to our estimates, as of end-9M 2011 the net debt/EBITDA and total debt/EBITDA ratios remained at around 1.0x and 1.2x levels seen at end-H1 2011. The total debt was up by 33% on end-2010 and some 7% on end-H1 2011. We presume that the qoq change in the total debt figure stemmed from the depreciation of the rouble against the dollar, since the company attracted no new debt in Q3 and made some minor repayments. The liquidity profile was well balanced at end-Q3 2011, with RUB 17 bn in short-term debt covered by about the same amount in cash and cash equivalents. We estimate that the company also had USD 350 mn (approx. RUB 10 bn) in available credit lines from international banks as well as some USD 195 mn (RUB 6 bn) in bank overdraft facilities. On the downside, according to Novatek almost 54% of its debt was denominated in USD as of the end of September, whereas in 9M 2011 about 31% of the company's revenues came from exports, meaning that Novatek is still somewhat susceptible to rouble devaluation risks in terms of its debt currency structure.

**Free cash flow (FCF) again impressed, at RUB 28 bn for 9M 2011 – a bounce of 90% compared to 9M 2010** – and exceeded the figure for the whole of FY 2010. We continue to believe that as things stand, planned CAPEX and dividend payments (approx. RUB 7.6 bn in H1 2011) can be comfortably met by this year's forecast cash flows. The company's interest coverage ratio remained at a towering 37x in 9M 2011.

**In September Novatek exercised two call options to purchase the remaining 49% stake in the Yamal LNG project.** The consideration for the acquisition was recognised as a payable, and effectively represents a future cash outflow of some USD 1 bn. Novatek paid the first instalment worth USD 456 mn in October, and the balance is due by the end of June 2012. As we understand it, the first instalment was partly funded by the proceeds of the disposal of a 20% interest in the project to Total for USD 425 mn. Although the deal leaves Novatek with an 80% stake in the project, the parties agreed that key decisions require the approval of both shareholders, meaning that Novatek has effectively ceded control, and in consequence since the start of Q4 Novatek has been accounting for the project using the equity method. On the upside, Vedomosti reports that Total has committed itself to capital injections into the project as well as shareholder loans disproportionate to its stake. Also positive is the fact that the outstanding USD 505 mn due for the 49% holding should be met by payments from prospective partners which intend to acquire a 29% interest in the project, with the result that Novatek is not expected to need to borrow to finance the acquisition.

As we wrote in our last CIS Corporate Eurobond Investor, **Fitch recently changed the outlook on the Novatek's rating from negative to stable.** Since we anticipated the rating action we view it as credit-neutral. To recap, S&P led the way in revising its outlook on Novatek's BBB- rating, upgrading it from negative to stable in July, and we expected Fitch to follow suit. In general, the latter's case for the outlook revision was similar to that advanced by S&P. Fitch argued that the additional borrowing by the company to complete the leveraged buyout in 2010 (discussed in detail in our earlier notes) had not had a material impact on the financial risk profile beyond a level commensurate with Novatek's credit ratings.

The recovery in the spreads on the company's paper has mirrored the rebound of the rest of the CIS corporate market since the recent sell-off. That said, it should be noted that the NOTKRM bonds have recorded a strong total return performance versus peers since end-August. Novatek's Eurobonds are currently trading slightly through the curves of the Russian private oils and about on par with Gazprom. We are going neutral/underweight on the company's paper over a three-month horizon.

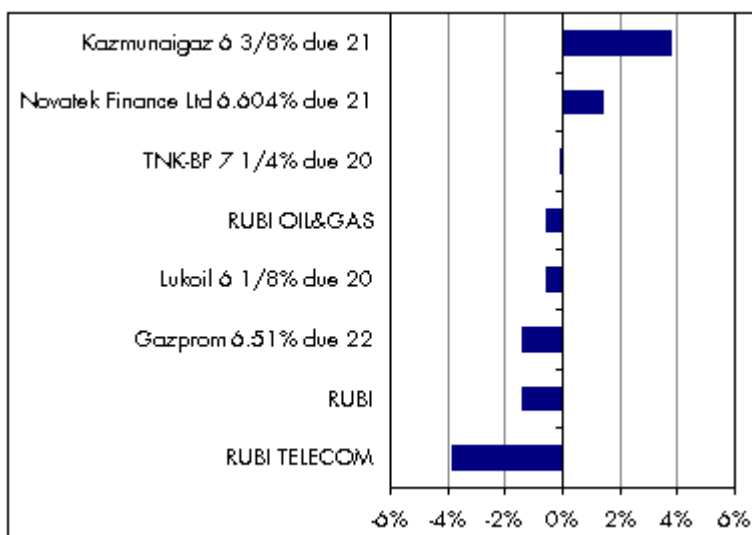
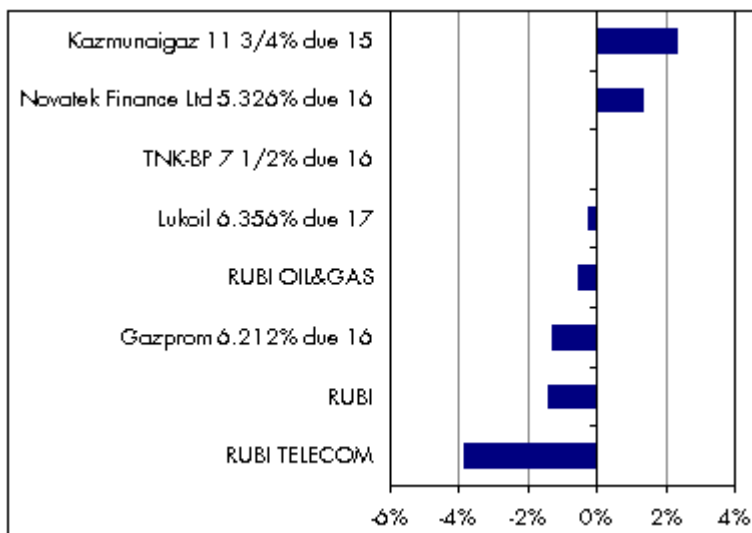
### **Novatek's key financial figures**

RUB mn

| <b>Income Statement</b>        | <b>2010</b> | <b>9M 2010</b> | <b>9M 2011</b> |
|--------------------------------|-------------|----------------|----------------|
| Revenues                       | 117,024     | 82,889         | 125,417        |
| Revenue growth (yoy)           | 30%         | 33%            | 51%            |
| EBITDA                         | 54,806      | 38,196         | 63,179         |
| EBIT                           | 48,190      | 33,262         | 56,872         |
| Net profit                     | 40,533      | 28,426         | 41,680         |
| <b>Cash Flow</b>               | <b>2010</b> | <b>9M 2010</b> | <b>9M 2011</b> |
| Cash from operating activities | 44,863      | 30,879         | 46,883         |
| Cash from investing activities | -68,842     | -17,849        | -51,314        |
| Cash from financing activities | 23,782      | -10,890        | 11,021         |
| Operating cash flow margin     | 38%         | 37%            | 37%            |
| Free cash flow                 | 22,227      | 15,549         | 29,749         |
| <b>Balance Sheet</b>           | <b>2010</b> | <b>9M 2010</b> | <b>9M 2011</b> |
| Total assets                   | 285,173     | 215,180        | 322,112        |
| LT interest bearing debt       | 47,074      | 23,614         | 78,732         |
| Cash and equivalents           | 10,238      | 12,463         | 16,892         |
| Net debt                       | 61,988      | 21,547         | 78,903         |
| ST debt                        | 25,152      | 10,396         | 17,063         |
| Total debt                     | 72,226      | 34,010         | 95,795         |
| <b>Ratios</b>                  | <b>2010</b> | <b>9M 2010</b> | <b>9M 2011</b> |
| EBITDA margin                  | 47%         | 46%            | 50%            |
| EBIT margin                    | 41%         | 40%            | 45%            |
| Profit margin                  | 35%         | 34%            | 33%            |
| Net debt/EBITDA                | 1.1 x       | 0.4 x          | 1.0 x          |
| Total debt/EBITDA              | 1.3 x       | 0.6 x          | 1.2 x          |
| Interest coverage ratio        | 110.3 x     | 101.1 x        | 37.1 x         |

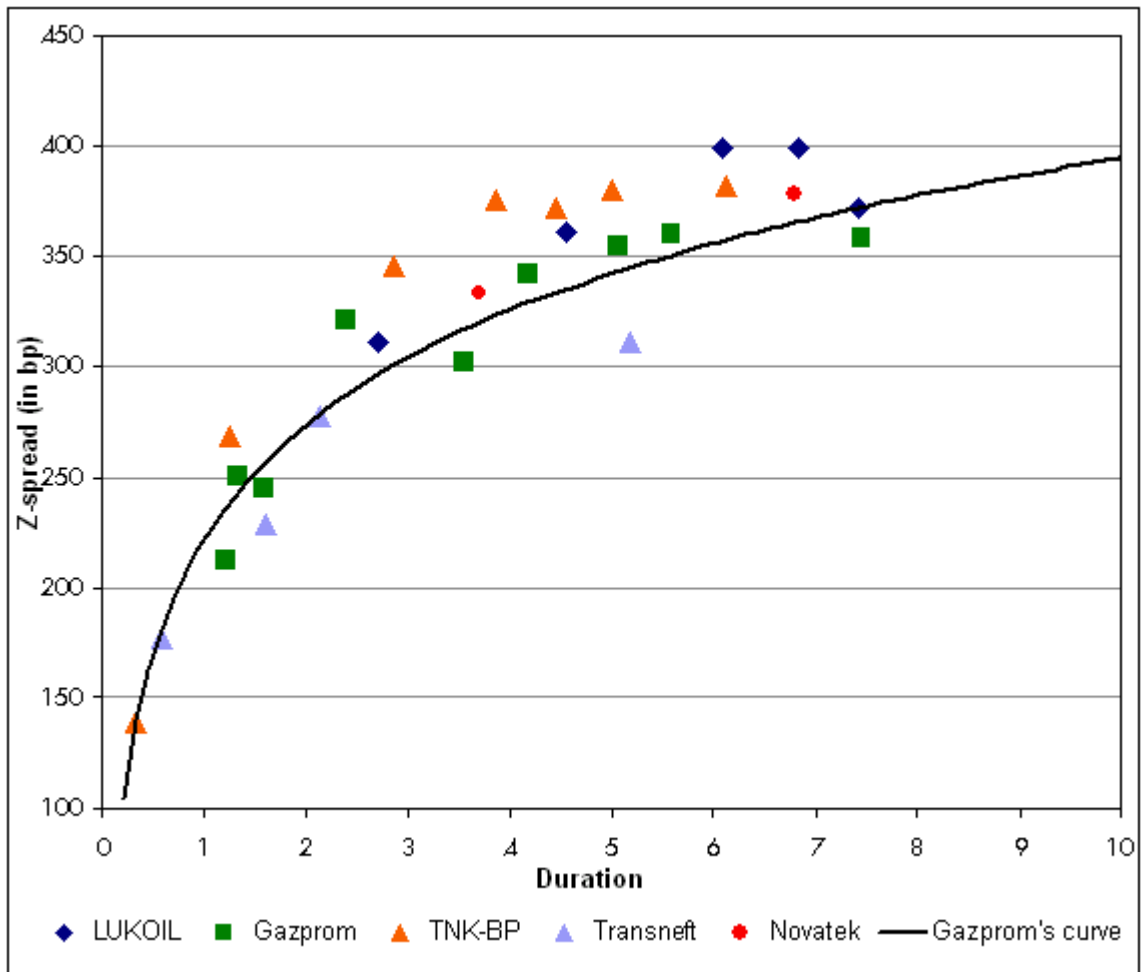
Source: Company data, Raiffeisen RESEARCH

### **Total return since end-August 2011**



Source: JP Morgan, Raiffeisen RESEARCH

### **Novatek vs. peers**



Source: Bloomberg, Raiffeisen RESEARCH