

Rating: Buy  
S&P 500: 1212

## Lukoil Oil Company After Yukos

<i>Symbol</i>	(LKOH) LUKOY	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$mm)</i>	6,300
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	117.75	<i>Natural Gas and Oil Production/Ebitda (%)</i>	49
<i>Pricing Date</i>	12/29/04	<i>Adjusted Reserves/Production NTM</i>	12.2
<i>Shares (mm)</i>	209	<i>EV/Ebitda</i>	4.4
<i>Market Capitalization (US\$mm)</i>	24,600	<i>PV/Ebitda</i>	7.3
<i>Debt (US\$mm)</i>	2,900	<i>Undeveloped Reserves (%)</i>	40
<i>Enterprise Value (EV) (US\$mm)</i>	27,500	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	4.86
<i>Present Value (PV) (US\$mm)</i>	46,300	<i>Present Value Proven Reserves(US\$/boe)</i>	2.26
<i>Net Present Value (US\$/share)</i>	208	<i>Present Value Proven Reserves(US\$/mcfe)</i>	0.38
<i>Debt/Present Value</i>	0.06	<i>Earnings Next Twelve Months (US\$/sh)</i>	14.73
<i>McDep Ratio - EV/PV</i>	0.59	<i>Price/Earnings Next Twelve Months</i>	8
<i>Dividend Yield (%/year)</i>	2.9	<i>Indicated Annual Dividend (US\$/sh)</i>	3.46

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and refined products.

Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

### Summary and Recommendation

We continue to recommend current purchase of the American Depositary Receipts of Russian producer, **Lukoil**, for investment in giant resources at modest value subject to political risk. The bankruptcy of Yukos may be creating an opportunity to buy Lukoil at a lower price than earlier in the year. Lukoil may have partly succeeded Yukos in export markets, including China. Exporters may sell oil at higher price, but the government taxes most of the benefit above \$35 a barrel or so. **ConocoPhillips (COP)** has acquired 10% of Lukoil and is likely to boost that to 20% in the next few years. Our estimate of net present value of US\$208 a share remains justifiable despite the Yukos affair, a liberal definition of reserves and high marginal tax rate tied to oil price.

### Cash Flow and Profits Depend on Access to International Markets

The most profitable production may be that which is accepted for transportation to international markets by the government controlled export pipelines. Where Lukoil refines its own crude oil it can get the equivalent of an international price in some of its gasoline sales.

Shortly we expect Lukoil to disclose financial results for the third quarter 2004. Preliminary disclosure of production volume indicated a flat trend with the second quarter. Despite the lack of more up-to-date information we project unlevered cash flow (Ebitda) for 2005 close to the amount implied by reported results for the first half of 2004 adjusted for futures prices (see table Next Twelve Months Operations).

Actual results could be a lot different. Lukoil Chief Executive, Mr. Vagit Alekperov, declared at a press conference on December 23 that the company stopped selling crude oil within Russia in the second half, according to *Bloomberg*. It now either refines its crude oil or sells it in export markets. Previously crude oil sold inside Russia received a low price.

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More oil is likely to be exported to China in 2005 by Lukoil and other Russian producers. Yet the amounts are limited because the mode of transportation is by rail. Similarly, Lukoil expects to export more oil through an expanded Baltic Sea outlet. That, too, seems to require rail transportation.

Lukoil Oil Company Next Twelve Months Operations										
	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>3/31/04</i>	<i>6/30/04</i>	<i>9/30/04</i>	<i>12/31/04</i>	<i>2004E</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>12/31/05</i>
<b>Volume</b>										
Oil (mmb)	154	158	160	160	<b>632</b>	156	158	160	160	<b>635</b>
Oil (mbd)	1,706	1,739	1,739	1,739	<b>1,731</b>	1,739	1,739	1,739	1,739	<b>1,739</b>
<b>Price</b>										
Oil (\$/bbl)										
WTI Cushing	35.23	38.34	43.89	48.40	<b>41.47</b>	41.29	41.37	40.78	40.22	<b>40.92</b>
Lukoil export	28.05	32.50	37.21	41.03	<b>34.77</b>	35.00	35.07	34.57	34.10	<b>34.68</b>
NY Harbor 3-2-1 (\$/bbl)	6.98	12.77	7.83	5.52	<b>8.28</b>	5.51	7.13	6.52	5.38	<b>6.14</b>
<b>Revenue (\$mm)</b>										
Oil	4,307	5,142	5,952	6,564	<b>21,964</b>	5,477	5,549	5,530	5,454	<b>22,010</b>
Other	2,275	2,885	2,885	2,885	<b>10,930</b>	2,885	2,885	2,885	2,885	<b>11,539</b>
Total	6,582	8,027	8,837	9,448	<b>32,894</b>	8,362	8,433	8,414	8,339	<b>33,549</b>
<b>Expense</b>										
Fixed	1,871	2,286	2,286	2,286	<b>8,728</b>	2,286	2,286	2,286	2,286	<b>9,142</b>
Variable	1,871	2,286	2,645	2,917	<b>9,720</b>	2,434	2,466	2,458	2,424	<b>9,783</b>
Other	1,391	1,777	1,991	2,123	<b>7,282</b>	2,124	2,012	2,049	2,122	<b>8,307</b>
<b>Ebitda (\$mm)</b>										
Exploration and Production	564	571	1,021	1,361	<b>3,517</b>	757	797	786	744	<b>3,084</b>
Other	884	1,108	894	762	<b>3,647</b>	761	873	836	763	<b>3,232</b>
Total Ebitda	1,448	1,679	1,914	2,122	<b>7,164</b>	1,518	1,670	1,622	1,507	<b>6,317</b>
Exploration	30	57	57	57	<b>201</b>	57	57	57	57	<b>228</b>
Deprec., Deplet., & Amort.	248	266	266	266	<b>1,046</b>	266	266	266	266	<b>1,064</b>
<b>Ebit</b>	1,170	1,356	1,591	1,799	<b>5,917</b>	1,195	1,347	1,299	1,184	<b>5,025</b>
Interest	68	75	75	75	<b>293</b>	75	75	75	75	<b>300</b>
<b>Ebt</b>	1,102	1,281	1,516	1,724	<b>5,624</b>	1,120	1,272	1,224	1,109	<b>4,725</b>
Income Tax	276	397	531	604	<b>1,807</b>	392	445	428	388	<b>1,654</b>
<b>Net Income (\$mm)</b>										
Exploration and Production	286	259	521	713	<b>1,779</b>	360	391	383	353	<b>1,487</b>
Other	533	618	456	399	<b>2,006</b>	362	429	407	362	<b>1,559</b>
Unallocated	8	7	8	9	<b>31</b>	6	7	6	6	<b>24</b>
Total	827	884	986	1,121	<b>3,817</b>	728	827	796	721	<b>3,071</b>
<b>Shares (millions)</b>	209	209	209	209	<b>209</b>	209	209	209	209	<b>209</b>
Per share (\$)	3.96	4.24	4.73	5.38	<b>18.30</b>	3.49	3.96	3.82	3.46	<b>14.73</b>
Ebitda Margin	13%	11%	17%	21%	<b>16%</b>	14%	14%	14%	14%	<b>14%</b>
Tax Rate	25%	31%	35%	35%	<b>32%</b>	35%	35%	35%	35%	<b>35%</b>

## Russian Reserves Generously Stated

Reducing reported reserves of Russian companies to the SEC standard would improve the credibility of those companies in the international stock market. We readily agree that the SEC standard understates likely future production. Yet conservative standards offer an essential minimum degree of assurance that usually forms the basis of our quantitative valuation. We can then consider less certain potential separately.

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## Yukos Illustrates Political Risk

The demise of oil producer, Yukos, is disconcerting for investors. The government essentially put the company out of business. Since we consider ourselves lucky for having dodged the Yukos bullet, we will not dwell on the rights and wrongs.

Investment in Russia requires patience with the pace of evolution to a fully democratic and thriving capitalist society. Leading international oil companies see the opportunities and are proceeding at a controlled pace. Investors in ConocoPhillips are participating in Lukoil indirectly. Investors in Lukoil can participate directly on practically the same basis as through COP. We like the more direct investment approach and as the major oil companies do, we can control our risk by not having too much concentration in a single political jurisdiction.

## Undervalued among Producer/Refiners

Perhaps consistent with the more limited transparency of information and higher political risk, Lukoil appears to be the most undervalued stock in its group (see table Rank by McDep Ratio).

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i> <i>29-Dec</i> <i>2004</i>	<i>Shares</i> <i>(mm)</i>	<i>Market</i> <i>Cap</i> <i>(\$mm)</i>	<i>Net</i> <i>Present</i> <i>Value</i> <i>(\$/sh)</i>	<i>Debt/</i> <i>Present</i> <i>Value</i>	<i>McDep</i> <i>Ratio</i>
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	72.08	125	8,990	20.00	0.74	1.68
Imperial Oil Limited (30%)	IMO	B3	58.23	107	6,220	58.00	0.10	1.00
Marathon Oil Corporation	MRO	B3	36.73	347	12,750	40.00	0.31	0.94
Norsk Hydro ASA	NHY	B1	78.54	254	19,960	90.00	0.18	0.90
Suncor Energy	SU	B3	34.64	460	15,930	42.00	0.12	0.85
ConocoPhillips	COP	B1	86.83	702	60,900	110.00	0.25	0.84
Petro-Canada	PCZ	B3	50.33	269	13,560	68.00	0.18	0.79
PetroChina Company Ltd (10%)	PTR	B2	53.73	176	9,450	82.00	0.06	0.67
Lukoil Oil Company	LUKOY	B2	117.75	209	25,000	208.00	0.06	0.59
<i>Total or Median</i>					<i>173,000</i>		<i>0.18</i>	<i>0.85</i>

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative buy

S2 = Short half unlevered position, S3 = Short quarter unlevered position

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

## Buy Oil and Gas Producers at Mid Decade

Three to five-fold gain potential for oil and gas price over the next 5 to 13 years justifies investment in recommended oil and gas producers including LUKOY, in our opinion. Supporting improving prospects, the average futures prices of oil and gas for continuous delivery over the next six years are in a multi-year uptrend defined by the current quotes above the 40-week average. The current benchmark oil average futures price for the next six years is about \$38 a barrel. That is higher than our estimate that current stock price of Lukoil reflects a constant real oil price of perhaps \$28 a barrel.

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