

Rating: Buy
 S&P 500: 1183

Lukoil Oil Company Profit Advances

<i>Symbol</i>	(LKOH) LUKOY	<i>Ebitda Next Twelve Months ending 12/31/05 (US\$m)</i>	8,700
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	118.25	<i>Natural Gas and Oil Production/Ebitda (%)</i>	40
<i>Pricing Date</i>	1/11/05	<i>Adjusted Reserves/Production NTM</i>	12.2
<i>Shares (mm)</i>	209	<i>EV/Ebitda</i>	3.0
<i>Market Capitalization (US\$m)</i>	24,700	<i>PV/Ebitda</i>	5.2
<i>Debt (US\$m)</i>	1,500	<i>Undeveloped Reserves (%)</i>	40
<i>Enterprise Value (EV) (US\$m)</i>	26,200	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	5.58
<i>Present Value (PV) (US\$m)</i>	44,900	<i>Present Value Proven Reserves(US\$/boe)</i>	1.82
<i>Net Present Value (US\$/share)</i>	208	<i>Present Value Proven Reserves(US\$/mcf)</i>	0.30
<i>Debt/Present Value</i>	0.03	<i>Earnings Next Twelve Months (US\$/sh)</i>	22.06
<i>McDep Ratio - EV/PV</i>	0.58	<i>Price/Earnings Next Twelve Months</i>	5
<i>Dividend Yield (%/year)</i>	2.9	<i>Indicated Annual Dividend (US\$/sh)</i>	3.45

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

Results for the third quarter of 2004 reported on January 11, 2005 exceeded our cautious projections and reinforce appreciation prospects for the buy-recommended stock. There is enough profit potential in Russian oil production and refining/marketing that despite high transportation costs and high excise taxes Lukoil's profits have advanced. Next twelve months cash flow, Ebitda, is perhaps half of a competitive international level on an integrated basis. Lukoil's unlevered multiple of cash flow, EV/Ebitda, is the lowest of any stock in our coverage. The stock has appreciation potential to our estimated present value of \$208 a share. We would compensate for the political risk by owning half a normal unlevered position in a diversified energy portfolio.

Rising Cash Flow despite High Transportation Cost and Excise Tax

Gains of 12% in Russian export price contributed to a 32% gain in Ebitda that drove a 59% gain in earnings in the third quarter compared to the second quarter 2004 (see table Next Twelve Months Operations). A lower than normal share of cash flow, 40%, is attributed to the production business. Yet, the company produces about twice as much oil as it refines. Crude oil for domestic consumption commands a low price in Russia. As a result the downstream business provides an opportunity to earn some of the profits that are diverted to transportation and excise tax.

The company laments that the government-controlled pipeline and rail transportation system charges costs that equal all other operating costs of producing and refining. A spokesperson calls it "ridiculous".

The excise tax applies to exports. Like the politically-named "windfall profits tax" the U.S. government once imposed, the Russian crude oil tax applies disproportionately as price increases.

Please see disclosures on the final page.

Lukoil Oil Company
Next Twelve Months Operations

	<i>Q1</i>	<i>Q2</i>	<i>Q3</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>
Volume										
Oil (mmb)	154	158	159	159	630	156	157	159	159	631
Oil (mbd)	1,706	1,739	1,730	1,730	1,726	1,730	1,730	1,730	1,730	1,730
Price										
Oil (\$/bbl)										
WTI Cushing	35.23	38.34	43.89	48.30	41.44	45.35	44.89	43.87	42.93	44.26
Lukoil export	28.05	32.50	36.52	40.18	34.37	37.73	37.35	36.50	35.72	36.82
NY Harbor 3-2-1 (\$/bbl)	6.98	12.78	7.83	5.17	8.19	6.31	7.88	7.31	6.34	6.96
Revenue (\$mm)										
Oil	4,307	5,142	5,813	6,395	21,657	5,875	5,879	5,810	5,685	23,249
Other	2,275	2,885	4,009	4,009	13,179	4,009	4,009	4,009	4,009	16,038
Total	6,582	8,027	9,822	10,405	34,836	9,884	9,889	9,819	9,694	39,287
Expense										
Fixed	1,871	2,286	2,466	2,466	9,088	2,466	2,466	2,466	2,466	9,863
Variable	1,871	2,286	2,466	2,713	9,336	2,492	2,494	2,465	2,412	9,862
Other	1,391	1,777	2,677	2,904	8,749	2,781	2,628	2,679	2,767	10,855
Ebitda (\$mm)										
Exploration and Production	564	571	881	1,217	3,233	917	919	879	808	3,523
Other	884	1,108	1,332	1,106	4,430	1,228	1,381	1,331	1,243	5,182
Total Ebitda	1,448	1,679	2,213	2,323	7,663	2,145	2,301	2,210	2,050	8,706
Exploration	30	57	38	38	163	38	38	38	38	152
Deprec., Deplet., & Amort.	248	266	292	292	1,098	292	292	292	292	1,168
Ebit	1,170	1,356	1,883	1,993	6,402	1,815	1,971	1,880	1,720	7,386
Interest	68	75	77	77	297	77	77	77	77	308
Ebt	1,102	1,281	1,806	1,916	6,105	1,738	1,894	1,803	1,643	7,078
Income Tax	276	397	397	670	1,740	608	663	631	575	2,477
Net Income (\$mm)										
Exploration and Production	286	259	528	647	1,720	479	488	463	418	1,848
Other	533	618	871	588	2,610	642	733	700	643	2,718
Unallocated	8	7	10	9	34	8	9	9	8	34
Total	827	884	1,409	1,245	4,365	1,130	1,231	1,172	1,068	4,601
Shares (millions)	209	209	209	209	209	209	209	209	209	209
Per share (\$)	3.96	4.24	6.76	5.97	20.93	5.42	5.90	5.62	5.12	22.06
Ebitda Margin (E&P)	13%	11%	15%	19%	15%	16%	16%	15%	14%	15%
Tax Rate	25%	31%	22%	35%	28%	35%	35%	35%	35%	35%

Profit Suppression May Fade

It seems to be human nature for governments to extract a disproportionate share of oil profits when they can and to attempt to shield consumers from price increases. The question is how long might the policies last. When the government and its citizens feel the need for more supply, the policies usually change eventually to encourage that outcome. The gradual unfolding of an improved environment for energy producers in Russia may provide a continuing source of gain for Lukoil.

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