

RatingsDirect®

OA0 NOVATEK

Primary Credit Analyst:

Rachel J Lion, CA, London (44) 20-7176-6680; rachel.lion@standardandpoors.com

Secondary Contact:

Elena Anankina, CFA, Moscow (7) 495-783-4130; elena.anankina@standardandpoors.com

Table Of Contents

Rationale

Outlook

Standard & Poor's Base-Case Scenario

Company Description

Business Risk

Financial Risk

Liquidity

Covenant Analysis

Other Modifiers

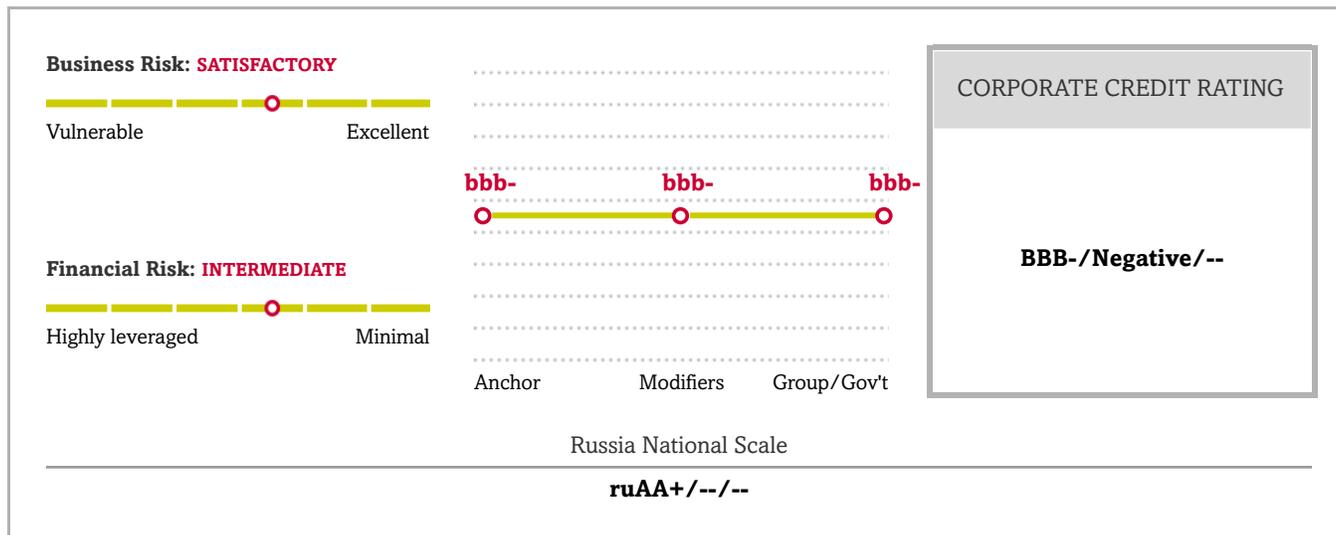
Rating Above The Sovereign

Ratings Score Snapshot

Reconciliation

Related Criteria And Research

OAO NOVATEK



Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
<ul style="list-style-type: none"> • Position as Russia's largest independent gas producer, with a solid reserve base. • Strong production growth potential. • Strong profitability, which benefits from high-quality onshore reserves and low production costs, as well as an increasing share of higher value-added products and a high share of lower-taxed condensate. • Good track record of containing low production costs. • Exposure to Russian country risks, including taxes, regulations, volatility of the U.S. dollar/Russian ruble exchange rate, and uncertainty regarding developments in the Russian gas industry. 	<ul style="list-style-type: none"> • Our expectation of negative free cash flow in 2014 as a result of Novatek's part shareholder loan funding of the Yamal Liquefied Natural Gas (LNG) and Severenergia joint ventures. • Significant uncertainties regarding the structure of future project financing and potential project cost increases. • Any further sales of joint venture interests could bring in material cash flow for Novatek, and represent upside risk to our base-case forecast.

Outlook: Negative

Standard & Poor's Ratings Services' negative outlook on Russia-based gas extraction group OAO Novatek reflects that on the Russian Federation, as we do not expect that the company would be able to withstand a sovereign default, should one ever occur.

Downside scenario

We would likely lower the rating on Novatek if we lowered the sovereign rating on the Russian Federation. Novatek has a favorable track record of managing country risk, but we will continue to view the company in the context of its standing in Russia's developing political and institutional environment, and any change could lead to rating pressure. This would include any company-specific sanctions, which are not part of our base-case scenario.

Negative pressure could also arise if Novatek's funds from operations (FFO) to debt falls below 45% on a sustainable basis. Such a scenario could arise if, for example, project financing for Yamal LNG is not arranged as expected and Novatek needs to finance a larger part of the project's investments itself. Such a scenario could also arise as a result of deterioration in operating cash flow due to adverse regulatory changes, or operational risks.

Upside scenario

We could revise the outlook on Novatek to stable if we revised the outlook on the sovereign to stable. We do not see any further near-term upside for the rating, given Novatek's increased investments in sizable joint ventures.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> We expect healthy production growth in both gas and liquids, albeit at a substantially slower pace than we initially expected in 2014--about 2%-3% growth in natural gas production and 20%-30% in liquids production--following a fire at Severenergia's Urengoykoye field. However, we understand that this will not result in a material increase in capex. We assume a strong link between stable condensate and crude oil prices. We expect Russian domestic gas prices to remain broadly flat in 2014 in ruble terms, in line with regulatory trends, and then to grow broadly in line with inflation. We assume that Novatek will keep a 60% stake in Yamal LNG. We assume that a significant part of the joint ventures will be financed by partners or project finance debt at the joint venture level on a non-recourse basis to Novatek. This remains a key uncertainty at present, as Novatek is currently in the process of arranging project financing. We factor our estimate of further shareholder loans to Novatek's joint ventures into our forecasts. 		2013A	2014E	2015E
	EBITDA margin (%)	41%	40%-45%	40%-45%
	FFO/Debt (%)	56%	50%-60%	50%-60%
	Debt/EBITDA (x)	1.3x	1.3x-1.7x	1.3x-1.7x
A--Actual. E--Estimate.				

Company Description

Novatek is Russia's largest independent natural gas producer and the second-largest holder of natural gas resources in Russia after Gazprom OAO. As of Dec. 31, 2013, Novatek had 12.5 billion barrels of oil equivalent (BOE) of proved reserves, with most reserves located onshore (or in areas that can be developed from onshore locations). Novatek's principal operating areas are concentrated in the Yamal-Nenets Autonomous Region in Western Siberia. In 2013, total production amounted to 439 million BOE, or an average daily production of 1,203 thousand BOE per day.

Business Risk: Satisfactory

Our assessment of Novatek's business risk profile as "intermediate" incorporates the following key factors:

- A large proven reserve base of 12.5 billion BOE, and a substantial reserve life of 29 years.
- Strong production growth in recent years and likely continued healthy production growth over the medium term, despite slower growth in 2014, partly mitigated by lower price increases.
- Solid profitability supported by low production costs, high-quality large onshore reserves, as well as an increasing share of higher value-added products following the launch of the Ust-Luga Gas Condensate Fractionation and

Transshipment Complex. Furthermore, Novatek's gas and condensate activities in Russia are subject to lower taxes than crude oil.

- Favorable track record of managing country risk, with strong production growth in recent years; access to attractive gas assets; tax holidays for sizable reserves, including those in the Yamal region; and recent liberalization of LNG exports.

These strengths are partly offset by the following constraining factors:

- Growing capex needs to support the group's ambitious growth plans. We expect that Severenergia and Yamal LNG joint ventures will finance a major part of their capex without recourse to Novatek over the medium to long term, but we assume that Novatek will extend further sizable shareholder loans to the joint ventures in the near term. Furthermore, there are typically high financing, start-up, and operational risks associated with such large and important projects.
- Heavy exposure to Russia, which we view as a high-risk country. Novatek could be exposed to potential changes in taxes and regulations, as well as cost inflation and foreign-exchange rate changes. Even though Novatek's gas prices are not regulated, we believe they depend indirectly on the regulated gas price for Russia's largest gas producer Gazprom. After several years of ongoing increases, we expect regulated domestic gas prices to stay flat in 2014 in ruble terms and increase only gradually in subsequent years. In our base-case scenario, we do not assume any major changes in the Russian tax and regulatory regime for the gas industry.
- The risk of demand fluctuations and growing competition on the domestic gas market. Although Novatek's business model proved resilient in the recent economic downturn, we do not exclude the possibility that going forward, slower economic growth and increasing dependent gas production in Russia could affect Novatek's volumes.

S&P Base-Case Operating Scenario

- Production growth, including an increased share of higher value-added products.
- No 2014 gas price growth and a modest increase linked to inflation in subsequent years.
- Brent oil price at \$100 per barrel (/bbl) in 2014 and \$95/bbl thereafter.
- Ongoing ruble devaluation against the U.S. dollar (Novatek's debt is 70% U.S. dollar-denominated).
- No major changes to the Russian tax regime.

Peer comparison

Table 1

OAO NOVATEK Peer Comparison

	OAO NOVATEK	OAO LUKOIL	Gazprom OAO
Rating as of June 3, 2014	BBB-/Negative/--	BBB-/Negative/--	BBB/Negative/A-2
	--Average of past three fiscal years--		
(Mil. \$)			
Revenues	7,829.1	138,091.0	153,876.7
EBITDA	3,278.4	20,563.3	64,722.1
Funds from operations (FFO)	2,551.0	17,086.2	54,315.3
Net income from continuing operations	3,122.0	9,731.0	38,123.6
Cash flow from operations	2,331.6	17,020.5	53,508.2
Capital expenditures	1,360.6	12,216.0	45,024.2
Free operating cash flow	971.0	4,804.5	8,484.0

Table 1

OA0 NOVATEK Peer Comparison (cont.)			
Discretionary cash flow	373.7	2,387.2	3,951.9
Cash and short-term investments	132.6	272.8	4,293.4
Debt	3,872.3	8,800.5	49,545.4
Equity	9,492.2	73,503.0	270,680.1
Adjusted ratios			
EBITDA margin (%)	41.8	14.9	42.1
Return on capital (%)	23.4	17.2	16.7
EBITDA interest coverage (x)	15.4	26.2	19.9
FFO cash interest coverage (x)	15.3	33.8	37.2
Debt/EBITDA (x)	1.2	0.4	0.8
FFO/debt (%)	65.8	194.2	110.0
Cash flow from operations/debt (%)	60.1	193.4	108.1
Free operating cash flow/debt (%)	24.9	54.6	17.2
Discretionary cash flow/debt (%)	9.5	27.1	8.1

Financial Risk: Intermediate

We view Novatek's financial risk profile as "intermediate," with FFO to debt significantly above 45% and weakening free operating cash flow (FOCF) as a result of heavy investments in joint ventures. Over the medium to longer term, we expect these projects to be highly profitable and to bring substantial cash dividends to Novatek.

We believe that Novatek will continue to benefit from growing production and a competitive cost structure, and will avoid any further increases in its investment program, although this remains a key downside risk for the company. We understand, however, that the Yamal LNG and Severenergia joint ventures will remain equity investments for Novatek, with the majority of capex financed on a non-recourse basis.

S&P Base-Case Cash Flow And Capital Structure Scenario

- We expect dividends in line with the company's 30% payout policy.
- We expect FOCF to be negative in 2014 due to high capex and shareholder loans to joint ventures.

Financial summary

Table 2

OA0 NOVATEK Financial Summary					
--Fiscal year ended Dec. 31--					
(Mil. RUB)	2013	2012	2011	2010	2009
Rating history	BBB-/Stable/--	BBB-/Stable/--	BBB-/Stable/--	BBB-/Negative/--	BB+/Positive/--
Revenues	298,158.0	211,109.0	239,273.0	117,420.0	89,663.0
EBITDA	122,609.0	99,393.0	90,768.0	57,430.0	40,138.0
Funds from operations (FFO)	92,300.4	76,807.8	74,219.6	44,705.0	32,074.0
Net income from continuing operations	110,006.0	69,458.0	119,655.0	40,533.0	26,043.0

Table 2

OAO NOVATEK Financial Summary (cont.)					
Cash flow from operations	81,238.4	72,549.8	68,411.6	42,655.0	33,194.0
Capital expenditures	57,781.0	39,316.0	32,978.0	22,636.0	16,238.0
Free operating cash flow	23,457.4	33,233.8	35,433.6	20,019.0	16,956.0
Discretionary cash flow	1,455.4	13,515.8	20,267.6	10,151.0	9,328.0
Cash and short-term investments	1,981.3	4,607.5	5,957.8	2,559.5	2,633.0
Debt	165,878.9	123,963.7	79,706.8	66,250.5	31,512.0
Equity	373,057.0	291,195.4	241,565.2	167,586.0	133,212.0
Adjusted ratios					
EBITDA margin (%)	41.1	47.1	37.9	48.9	44.8
Return on capital (%)	22.0	22.3	27.0	23.7	23.0
EBITDA interest coverage (x)	13.8	16.6	16.6	25.8	18.9
FFO cash interest coverage (x)	12.8	16.5	18.4	20.4	18.4
Debt/EBITDA (x)	1.4	1.2	0.9	1.2	0.8
FFO/debt (%)	55.6	62.0	93.1	67.5	101.8
Cash flow from operations/debt (%)	49.0	58.5	85.8	64.4	105.3
Free operating cash flow/debt (%)	14.1	26.8	44.5	30.2	53.8
Discretionary cash flow/debt (%)	0.9	10.9	25.4	15.3	29.6

Liquidity: Adequate

We view Novatek's liquidity as "adequate" under our criteria, with a ratio of liquidity sources to liquidity uses exceeding 1.2x for the 12 months from April 1, 2014. Although Russian companies' access to capital markets has been difficult in early 2014, and we expect it to remain volatile, we believe that Novatek has good relationships with Russian state-owned banks. In our liquidity assessment, we assume that the major part of joint venture capex will be financed on a non-recourse basis to Novatek. We understand that Russian state-owned banks and large Chinese banks are planning to arrange project financing for Yamal LNG by year-end 2014.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> A significant cash balance of RUB43.3 billion as of March 31, 2014, following the receipt of disposal proceeds from the divestment of a 20% share in the Yamal LNG joint venture. Proceeds of RUB35.0 billion for the sale of a 9.8% stake in Severenergia were received in April from Gazprom Neft. Our expectation of solid FFO generation of above RUB100 billion in 2014. Only RUB1.7 billion available under credit line facilities, following full draw-down of a syndicated credit line facility in March 2014. 	<ul style="list-style-type: none"> Large capex requirements of about RUB70 billion, plus further sizable shareholder loans to joint ventures. Dividends in line with the 30% payout policy of about RUB26 billion. Minimal short-term debt maturities. We note, however, that significant repayments are due in one year's time.

Debt maturities

Table 3

ОАО Novatek Debt Maturities As Of March 31, 2014

(Bil. RUB)	
2014	1,619
2015	57,629
2016	30,198
2017	16,286
Thereafter	62,699

Covenant Analysis

Compliance Expectations

We expect that Novatek will have sufficient headroom under its key covenants, which require a consolidated leverage ratio of below 3.0x and EBITDA interest coverage of more than 4x.

Other Modifiers

Modifiers do not have an impact on the rating on Novatek. We note Novatek's recent sales of stakes in Yamal LNG and Severenergia and that any further sales could bring in material cash flow for Novatek, and upside to our base-case forecasts.

Rating Above The Sovereign

The rating on Novatek can be no higher than the Russian sovereign rating, given the company's very high exposure to Russia from both an operating and financial standpoint (especially in view of Novatek's sizable joint ventures that are not yet fully financed). We do not expect that the company would be able to withstand a sovereign default, should one ever occur.

Ratings Score Snapshot

Corporate Credit Rating

BBB-/Negative/--

Business risk: Satisfactory

- **Country risk:** High
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Reconciliation

Table 3

Reconciliation Of OAO NOVATEK Reported Amounts With Standard & Poor's Adjusted Amounts

--Fiscal year ended Dec. 31, 2013--

OAO NOVATEK reported amounts										
<small>(Mil. RUB)</small>										
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
Reported	165,621.0	370,198.0	298,158.0	122,067.0	106,277.0	5,099.0	122,067.0	88,525.0	22,002.0	57,781.0
Standard & Poor's adjustments	--	--	--	--	--	--	--	--	--	--
Interest expense (reported)	--	--	--	--	--	--	(5,099.0)	--	--	--
Interest income (reported)	--	--	--	--	--	--	2,341.0	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(23,392.0)	--	--	--
Postretirement benefit obligations/deferred compensation	1,627.0	--	--	90.0	90.0	90.0	16.8	(67.2)	--	--
Surplus cash	(5,943.8)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	3,460.0	(3,460.0)	--	--	--
Share-based compensation expense	--	--	--	25.0	--	--	25.0	--	--	--
Asset retirement obligations	2717.6	--	--	--	--	248	(198.4)	(198.4)	--	--
Exploration costs	--	--	--	427.0	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	2,229.00	--	--	--	--	--

Table 3

Reconciliation Of OAO NOVATEK Reported Amounts With Standard & Poor's Adjusted Amounts (cont.)											
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	--	(7,021.0)	--	--
Non-controlling Interest/Minority interest	--	2,859.0	--	--	--	--	--	--	--	--	--
Debt - Accrued interest not included in reported debt	1,857.0	--	--	--	--	--	--	--	--	--	--
Total adjustments	257.9	2,859.0	0.0	542.0	2,319.0	3,798.0	(29,766.6)	(7,286.6)	0.0	0.0	

Standard & Poor's adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	165,878.9	373,057.0	298,158.0	122,609.0	108,596.0	8,897.0	92,300.4	81,238.4	22,002.0	57,781.0

We acknowledge the contribution of Ekaterina Kulikova in the preparation of this report.

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors For The Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Crude Oil And Natural Gas Price Assumptions For Corporates And Sovereigns, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 6, 2014)

OAO NOVATEK	
Corporate Credit Rating	BBB-/Negative/--
<i>Russia National Scale</i>	ruAA+/--/--
Senior Unsecured	
<i>Russia National Scale</i>	ruAA+

Ratings Detail (As Of June 6, 2014) (cont.)

Senior Unsecured		BBB-
Corporate Credit Ratings History		
29-Apr-2014		BBB-/Negative/--
06-Jul-2011		BBB-/Stable/--
19-Nov-2010		BBB-/Negative/--
28-Oct-2010		BBB-/Watch Neg/--
23-Jun-2010		BBB-/Stable/--
07-Jul-2009		BB+/Positive/--
19-Nov-2010	<i>Russia National Scale</i>	ruAA+/--/--
28-Oct-2010		ruAA+/Watch Neg/--
11-Jul-2008		ruAA+/--/--
Related Entities		
Novatek Finance Ltd.		
Senior Unsecured		BBB-

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

Copyright © 2014 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.