



Independent Stock Idea

June 3, 2010

rating: contrarian buy
s&p 500: 1098

Lukoil (LUKOY) Underrated Oil Performer

<i>Symbol</i>	LUKOY	<i>Ebitda Next Twelve Months ending 6/30/11 (US\$mm)</i>	14,700
<i>Rating</i>	Contrarian Buy	<i>North American Natural Gas/Ebitda (%)</i>	0
<i>Price (US\$/sh)</i>	50.10	<i>Natural Gas and Oil Production/Ebitda (%)</i>	59
<i>Pricing Date</i>	6/2/10	<i>Adjusted Reserves/Production NTM</i>	15.7
<i>Shares (mm)</i>	847	<i>EV/Ebitda</i>	3.3
<i>Market Capitalization (US\$mm)</i>	42,400	<i>PV/Ebitda</i>	8.2
<i>Debt (US\$mm)</i>	5,700	<i>Undeveloped Reserves (%)</i>	42
<i>Enterprise Value (EV) (US\$mm)</i>	48,100	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	12.10
<i>Present Value (PV) (US\$mm)</i>	120,000	<i>Present Value Proven Reserves(US\$/boe)</i>	5.20
<i>Net Present Value (US\$/share)</i>	135	<i>Present Value Proven Reserves(US\$/mcfe)</i>	0.87
<i>Debt/Present Value</i>	0.05	<i>Earnings Next Twelve Months (US\$/sh)</i>	8.14
<i>McDep Ratio - EV/PV</i>	0.40	<i>Price/Earnings Next Twelve Months</i>	6
<i>Dividend Yield (%/year)</i>	3.3	<i>Indicated Annual Dividend (US\$/sh)</i>	1.67
Note: Estimated cash flow and earnings tied to one-year futures prices for oil.			
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.			
Estimated present value presumes a long-term price for oil of US\$75 a barrel and natural gas, \$8 a million btu.			
For historical research on Lukoil since 2004 see www.mcdep.com/2luk.htm			

Summary and Recommendation

Buy-recommended **Lukoil (LUKOY)** offers unlevered appreciation potential of 150% to a McDep Ratio of 1.0 where stock price would equal Net Present Value (NPV) of \$135 a share. Cash flow and profits were strong in the Russian downstream business in the first quarter of 2010 as disclosed on June 2 (see table [Next Twelve Months Operating and Financial Estimates](#)). Upstream oil cash flow also exceeded our expectations from three months ago. Producing almost 2 million barrels daily, Lukoil is the fourth largest oil producer in our coverage after **ExxonMobil (XOM)**, **BP plc (BP)** and **PetroChina (PTR)**. We value Lukoil's oil production at a multiple of cash flow considering reserve life, in line with our industry analysis (see table [Functional Cash Flow and Present Value](#)). The company generates healthy cash flow despite an unusually high excise tax burden that holds Ebitda margin to just 17%. A more normal level might be 50%. In other words, there is great potential for the Russian government to relax the tax burden to stimulate new investment and economic growth that would likely more than make up for the lower tax rate. It is a good sign for Lukoil that Prime Minister Putin participated in the ceremony to open Lukoil's oil platform in the Caspian Sea by smearing oil on his face in the traditional Russian fashion. A few positive moves by the government may also reduce the perceived political risk that appears to be holding back Lukoil stock.

Kurt H. Wulff, CFA



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Lukoil Oil Company									
Next Twelve Months Operating and Financial Estimates									
									Next Twelve Months
	Q1 3/31/09	Q4 12/31/09	Year 2009	Q1 3/31/10	Q2E 6/30/10	Q3E 9/30/10	Q4E 12/31/10	Year 2010E	6/30/11
Volume									
Natural gas (bcf)	134	140	526	167	169	171	171	677	677
Natural Gas (mmcf)	1,494	1,518	1,440	1,854	1,854	1,854	1,854	1,854	1,854
Days	90	92	365	90	91	92	92	365	365
Oil (mmb)	178	180	720	177	179	181	181	719	719
Oil (mbd)	1,976	1,953	1,972	1,971	1,971	1,971	1,971	1,971	1,971
Price									
Natural gas (\$/mcf)	0.88	1.01	0.95	1.00	1.00	1.00	1.00	1.00	1.00
Oil (\$/bbl)									
WTI Cushing	42.96	76.09	61.70	78.67	77.43	75.22	77.67	77.25	77.92
Lukoil export	43.73	74.79	61.28	75.40	74.21	72.09	74.44	74.03	74.67
NY Harbor 3-2-1 (\$/bbl)	9.18	5.22	8.34	7.15	11.68	10.02	5.88	8.68	8.27
Revenue (\$mm)									
Natural Gas	119	141	498	167	169	171	171	679	679
Oil	7,777	13,440	44,108	13,375	13,311	13,072	13,498	53,256	53,718
Other	6,968	10,841	36,975	10,527	10,527	10,527	10,527	42,107	42,107
Total	14,745	24,281	81,083	23,902	24,007	23,770	24,196	95,875	96,504
Ebitda (\$mm)									
Exploration and Production	2,119	2,048	8,971	2,236	2,157	2,119	2,187	8,698	8,703
Other	335	1,217	4,697	1,597	1,548	1,597	1,217	5,959	5,959
Total Ebitda	2,454	3,265	13,668	3,832	3,705	3,716	3,404	14,657	14,662
Exploration	37	30	218	117	60	60	60	297	240
Deprec., Deplet., & Amort.	994	936	3,937	1,030	1,030	1,030	1,030	4,120	4,120
Ebit	1,423	2,299	9,513	2,685	2,615	2,626	2,314	10,240	10,302
Interest	127	130	506	113	113	113	113	453	453
Ebt	1,296	2,169	9,007	2,572	2,501	2,513	2,201	9,787	9,849
Income Tax	390	441	1,994	522	750	754	660	2,686	2,955
Net Income (\$mm)									
Exploration and Production	1,607	1,044	5,456	1,194					
Other	(457)	1,120	2,194	803					
Unallocated	(244)	(436)	(637)	53					
Total	906	1,728	7,013	2,050	1,751	1,759	1,541	7,100	6,894
Shares (millions)									
Per share (\$)	1.07	2.04	8.28	2.42	2.07	2.08	1.82	8.38	8.14
Ebitda Margin (E&P)	27%	15%	20%	17%	16%	16%	16%	16%	16%
Tax Rate	30%	20%	22%	20%	30%	30%	30%	27%	30%



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Lukoil					
Functional Cash Flow and Present Value					
	<i>NTM Ebitda</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>(US\$mm)</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
				<i>(US\$mm)</i>	
Natural Gas	109	22.6	9.2	1,000	1%
Oil	8,590	15.7	9.4	81,000	68%
Downstream	6,000		6.3	38,000	32%
	14,700		8.2	120,000	100%
Debt (US\$mm)					5,700
Net Present Value (US\$mm)					114,300
Shares (mm)					847
Net Present Value - Standard Estimate (US\$/sh)					135
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					147

Disclaimer: This analysis was prepared by Kurt Wulff, Manager of McDep LLC. The firm used sources and data believed to be reliable, but makes no representation as to their accuracy or completeness. This analysis is intended for informational purposes and is not a solicitation to buy or sell a security. Past performance is no guarantee of future results.

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