Ukrnafta
Recommendation Alert

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Price USD 39.2

12m Target
USD 35.7

Having taken a pause to watch the development of Ukrnafta's possible restructuring, we have arrived at the conclusion that risk of the company's asset stripping is negligible now.

Our argument of low likelihood of Okhtyrkanaftogaz's and Kachanivsky GPP's segregation from Ukrnafta due to legal difficulty has been repeatedly brought up by various officials. Among them was Oleksiy Ivchenko, Naftogaz Ukrainy's CEO and apparently one of the interested parties in taking full control over Ukrnafta's assets. In addition, no moves have been made to date on the presidential resolution calling for initial steps towards restructuring Ukrnafta within 14 days. Although the issue of asset separation from Ukrnafta can still be discussed at the company's EGM, no shareholder meeting has been scheduled yet. We believe that Ukrnafta's next general meeting will be a regular AGM in 2006 and the issue of Okhtyrkanaftogaz/ Kachanivsky GPP is unlikely to appear on the agenda.

Leaving alone asset stripping question, the biggest news concerning Ukrnafta since the time of our last desk note (August 25, 2005) was a possible 30% increase of oil extraction royalties. The new draft on the 2005 state budget envisages oil extraction royalties of USD 141.4 per tonne. This partly offsets the positive impact of higher than expected prices for oil products on Ukrnafta's 2005 financials. In addition, no advances occurred as to Ukrnafta's long term strategy and its vertical integration remains stalled. Thus, despite favorable market conditions we have not found sufficient grounds for our 12 month target upgrade and leave it at USD 35.7 per share, a downside of 9% from current mid-market price of USD 39.2. We also re-instate our **HOLD** recommendation.