Ukraine / Oil & Gas

Concern Galnaftogaz

Back To Reality

HOLD

10 Nov 2006	**USD 0.0100**
12M Target	**USD 0.0110**

Interim results reveal that Galnaftogaz's growth came at the expense of tighter margins than we forecasted. Still, high fuel prices and solid sales per station bode well for the company's branded franchise, which so far has expanded in line with the management's plans. We increase our top-line expectations and network build-up rate. While eager to see how expansion plans develop next year, we took a more conservative stance and downgrade GLNG to HOLD, with the new target of USD 0.0110 per share, which still offers a 10% upside.

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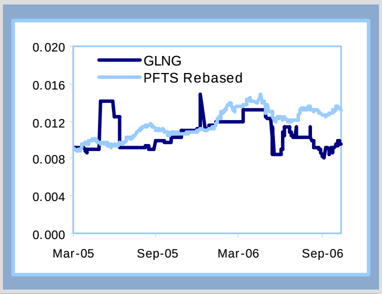
GLNG Mid-Market, USD



Market Information	
Bloomberg	GLNG UZ
Franfurt/Xetra	C9Z GR
No of Shares, mln	**16 000**
Reg S DR to Ord.	1:500
Market price, USD	**0.0100**
GDR price, USD	5.0
MCap, USD mln	**160.0**
Free Float, %	23.4%
FF MCap, USD mln	37.4

Stock Ownership	
Financial & Investment Energy Holding and related parties	76.6%
Other	23.4%

Ratios 2005	
Gross Margin	6.8%
EBITDA Margin	4.2%
Net Margin	1.9%
Net Debt/Equity	63%

Weak Margins Hurt Value, Despite Strong Sales

The lagging profitability Galnaftogaz reported in 2005 and 1H06 were not completely offset by stronger than expected fuel prices and solid tons per station. Low margins hurt Galnaftoaz's value, affecting its cash flows in the mid-term. We expect cash flows to recover in the long-term, if the company conforms to its more ambitious expansion plan. Profitability might be supported by restructuring, which was scheduled for next year and will consolidate Galnaftogaz's subsidiaries under the one umbrella by turning them into regional branches.

Setting Up for Faster Growth

The management has revised its expansion plan and set a new target for the size of GLNG's retail network at 442 filling stations, 56 stations more than in the previous plan. Accordingly, we have slightly upgraded our forecasted number of stations from 291 to 325 in perpetuity. We believe that future sales growth will depend primarily on the pace at which the company expands its retail network, thereby increasing physical turnover. As Ukrainian ex-tax fuel prices have already caught up with European levels, Ukrainian prices are forecast to mirror the global trend, growing at 4.3% 10-year CAGR at most.

Gaining Market Share

Despite a decrease in domestic fuel demand on the back of high prices, Galnaftogaz managed to improve its share in retail fuel market from 4.7% in 2004 to 5.3% in 2005, according to our estimates. We expect the company to capture at least 6.9% of the market in 2006.

Domestic Consumption to Recover

We believe that in the mid-term, a stabilization in oil prices will reveal the positive impact of structural factors, as improving consumer incomes and rapidly growing car sales will bring fuel consumption in Ukraine closer to European levels.

KEY FINANCIAL DATA*, USD mln

	Net Revenue	EBITDA	Net Income
2005	379.5	16.0	7.2
2006F	507.0	27.2	9.9
2007F	645.4	39.5	13.1
2008F	904.8	55.1	17.7
Spot Exchange Rate		5.05	

KEY RATIOS

	EV/S	EV/EBITDA	P/E
2005	0.52	12.45	22.27
2006F	0.48	8.90	16.09
2007F	0.46	7.44	12.22
2008F	0.38	6.28	9.02

** Financial data and ratios are converted to USD at the respective average annual exchange rates*

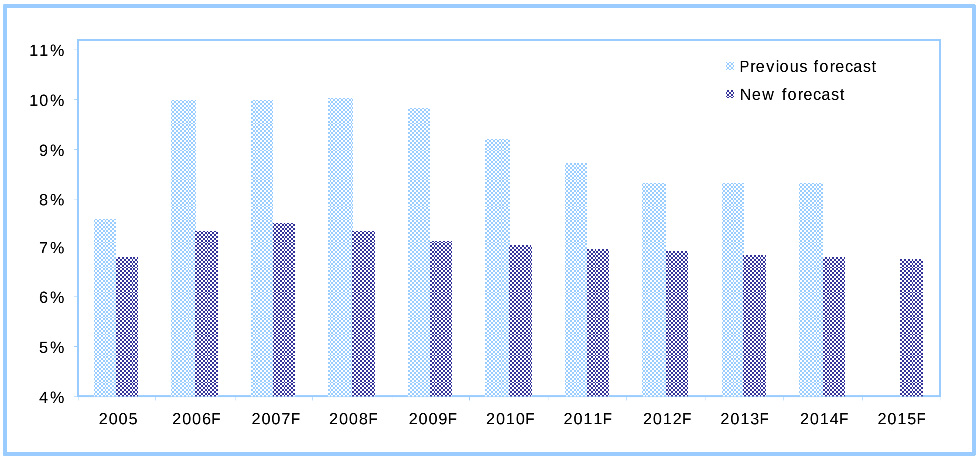
Margins Unexpectedly Weak

Galnaftogaz's 2005 (IFRS) and 1H06 (UAS) results indicate that this year its profitability is likely to be weaker compared with our previous forecast. In 2006 the company's gross margin is likely to reach neither the level of about 12% suggested by the management, nor our more conservative estimate of 10%.

According to *IFRS accounts*, Galnaftogaz reported a gross margin of 6.8%, 0.8 p.p lower than our earlier forecast of 7.6%. Financial statements based on *local accounting standards* (UAS) reveal a gross margin of 8.6% in 1H06, which is materially lower than the respective figure for 1H05 (11.9%) and for all of 2005 (10.3%).

Unjustified expectations have led us to downgrade Galnaftogaz's profitability forecast. We lowered our gross margin estimate for 2006 from 10% to a more conservative 7.4%, which is slightly higher than last year's actual figure of 6.8% (all forecasts are based on IFRS). We maintain our view that profitability will decrease slightly in the long-term, confined by toughening competition as the market gets saturated. We forecast the company's gross margin to stabilize at a level of 6.8% in the long-term, as narrow margins will push smaller companies out of the market and restrict entry opportunities.

Galnaftogaz Gross Margins: Revised Forecast



Source: Company data, Concorde Capital estimates

Restructuring May Help To Save On Costs

On its AGM in August Galnaftogaz's management announced that in 2007 it is going to restructure the company's subsidiaries into regional branches. According to management, this restructuring will remove inter-company operations and will reduce volatility in the company's working capital by consolidating its tax payments. In our view, restructuring may indeed prop up Galnaftogaz's profitability, though the size of the effect is hardly predictable.

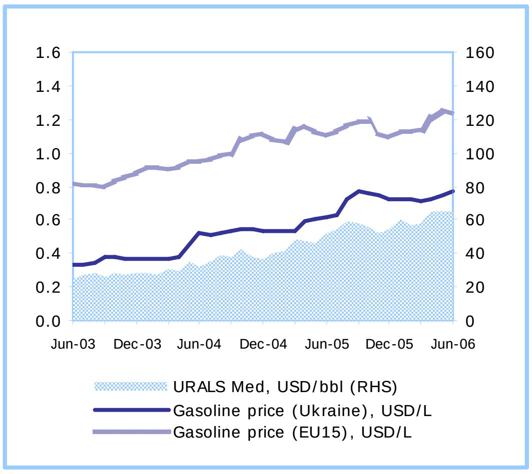
Sales Outperform On High Prices

We expect Galnaftogaz to outperform our previous forecast and report about USD 507 mln net revenues in 2006 (33.6% yoy growth), due to higher than expected growth of domestic fuel prices on the back of rising global oil prices. However, the effect of higher prices could not completely offset weaker than expected margins, which will affect gross profits in the mid-term. We expect gross profits to recover by 2009, driven by rapid expansion of the company's retail network.

Domestic Prices Driven By Global Factors

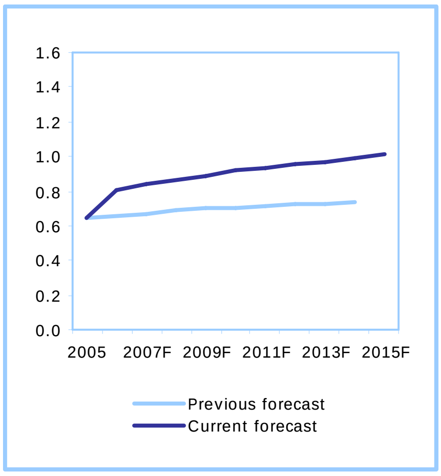
In 1H06 average domestic fuel prices followed global oil trend, at the rate mirroring the pace of average European prices. Gasoline prices grew by 28.6% yoy, the price of diesel fuel increased by 31.9% over the same period last year. We estimate that Galnaftogaz's 2006 average fuel price will increase by 25.9% yoy. We upgrade our forecast to reflect higher than expected growth rates in 2005-2006.

Domestic Gasoline Prices* vs URALS



** Gross prices (VAT and excise tax inclusive)*
Source: UPECO, IEA, Bloomberg

Average GLNG Fuel Price*, USD/L



** Gross prices (VAT and excise tax inclusive)*
Source: Company data, Concorde Capital estimates

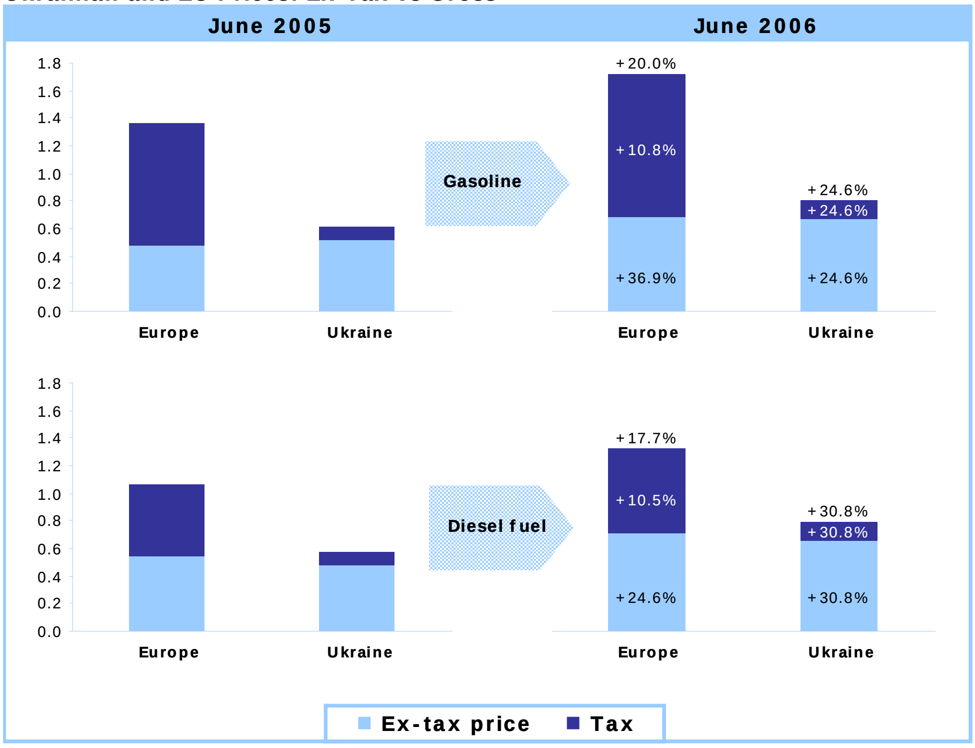
We forecast the growth in global oil prices to slow down in 2H06 and correct slightly downward in 2007. However, we believe next year's correction to be mitigated by domestic inflation, which will support fuel prices in Ukraine, resulting in around 4.5% growth next year.

In the long-term, we believe, local prices won't exceed the domestic inflation level and expect prices to grow at around 4.2% CAGR, which is close to our previous forecast.

Ukrainian Fuel Prices Are Already At EU Levels

According to our estimates, the average ex-tax domestic fuel prices are already in line with levels in the European Union. Although gross prices may indeed converge with European levels, most of the benefits are likely to go the state budget in the form of taxes.

Ukrainian and EU Prices: Ex-Tax vs Gross



Source: UPECO, IEA

We believe that in the foreseeable future Galnaftogaz's revenues will be driven by the volume of its physical turnover, rather than by prices, because the potential for growth of ex-tax prices looks exhausted.

New Plan Assumes Faster Growth

The management has increased its long-term target number of stations. We remain cautious and keep our assumption closer to our earlier forecast. We upgrade our revenue forecast to reflect unexpectedly high fuel prices in 2005-06, strong tons per station, and more ambitious expansion plans.

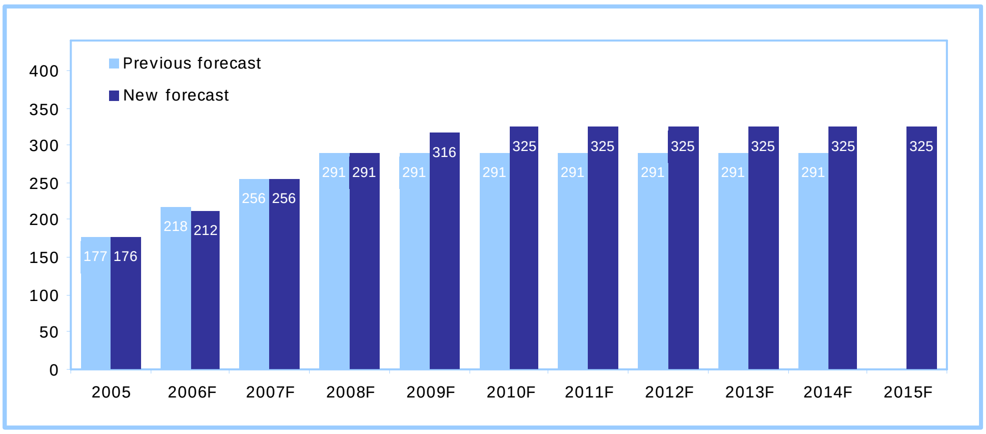
2005 as Expected, 2006 Forecast To Be Almost Met

Galnaftogaz's expansion rate in 2005 was generally in line with our expectations. The company is likely open 36 new stations by the end of the year, five stations less than our forecast. The company had 176 outlets at the end of 2005 (our forecast was 177) and is likely increase its network to 212 stations by the end of 2006 (our forecast was 218), including 160 OKKO stations. As of the end of October, the company was operating 202 stations (155 with the OKKO brand).

Expansion Plans Are Now More Ambitious

The company's management has revised its development plans upward, increasing the number of planned stations to 442 by 2012. This is a much more aggressive target compared to both the management's previous plan (351) and our forecast (291). Given that the company's number of stations are in line with our 2005 and 2006 expectations, we took Galnaftogaz new plans into account in our revised forecast. We assume the number of stations will reach 325 by the end of 2011 and flat thereafter, which is much closer to our previous forecast than to the management's new plan.

Number Of Filling Stations: Revised Forecast



Source: Company data, Concorde Capital estimates

Sales Per Station Improved as Expected, Unaffected By Fast Expansion

Despite lowering domestic oil product consumption, Galnaftogaz has managed to significantly improve its sales per station (SPS). Its high rate of network growth has not affected per-station volumes either. We believe the management will be able to increase Galnaftogaz's SPS further, so we leave our previous forecast virtually unchanged.

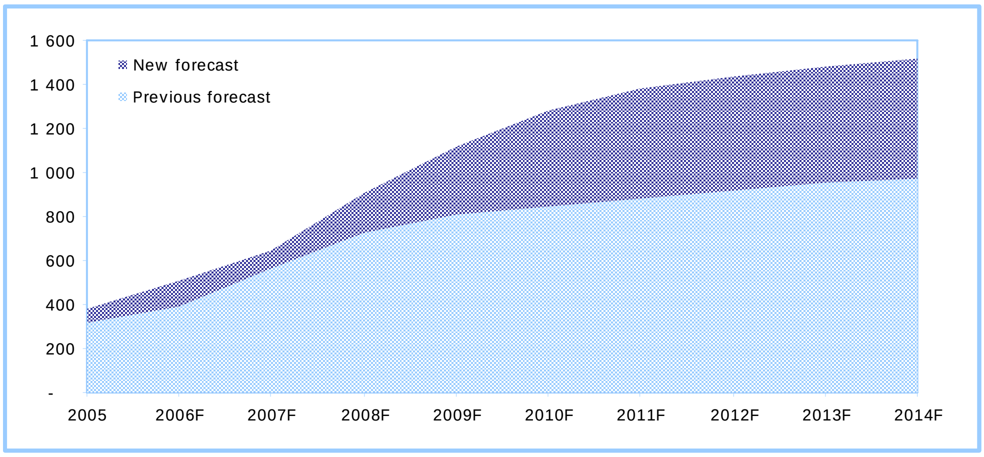
Top Line Up, Gross Profit Lagging

We upgrade Galnaftogaz's net revenue forecast based on 2005-06 results and new assumptions, which were discussed earlier in this report (see pages 3-5). The most important of which are:

- higher than expected fuel prices in 2005-2006,
- expected network expansion beyond 2006, and
- sales per station remaining strong.

Please refer to the Appendix 1 for the summary of revised forecasts.

Net Revenue: Forecast Revision, USD mln

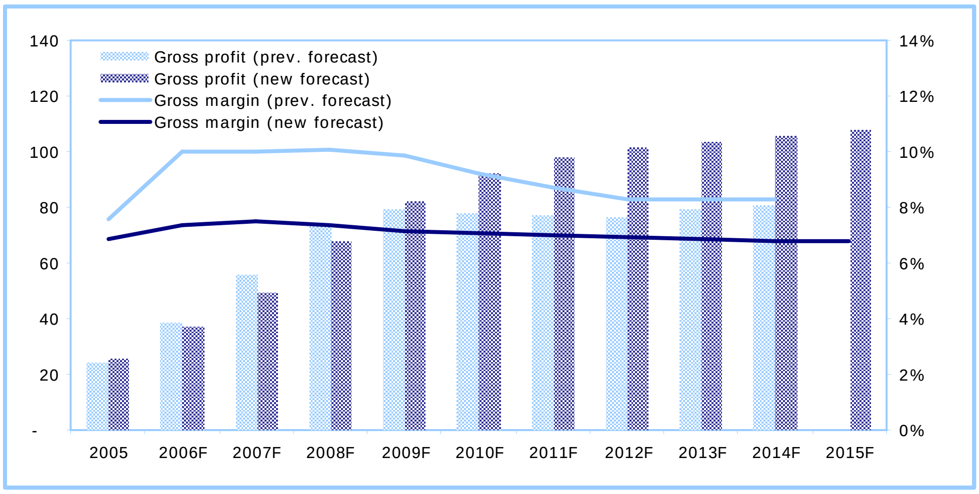


Source: Company data, Concorde Capital estimates

Outperforming Sales Unable To Offset Lower Margins

Strong sales will not offset the negative impact of low margins. Our forecast suggests that gross profits will fall short of the levels projected earlier, at least in 2006-2008. Beyond 2008, we expect gross profits to beat our previous projections, driven by faster expansion of Galnaftogaz's network.

Gross profits vs. gross margins



Source: Company data, Concorde Capital forecast

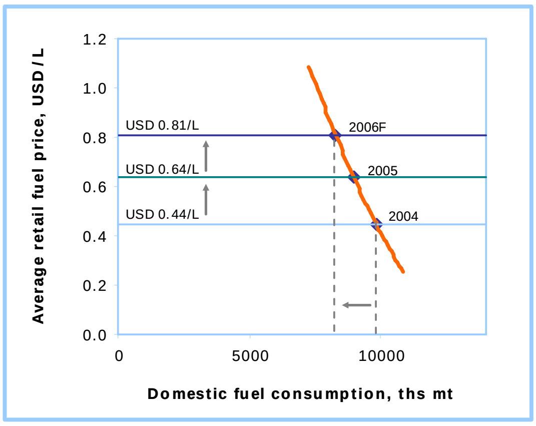
Capturing The Market Despite Sluggish Consumption

According to market statistics, apparent domestic consumption of light oil products decreased by about 9% in 2005 to 9.8 mln mt per year. The data for 1H06 indicates that we'll see a decrease of around 7.4% in 2006. We believe that domestic demand was mainly affected by rapid growth in fuel prices.

Despite decreasing demand and higher competition, retail network expansion and strong sales per station enabled Galnaftogaz to improve its market share from 3.1% in 2004 to an estimated 5.4% in 2006. Based on the estimated size of the retail market (~6.5 mln ton per year) and conservatively assuming it was stable since 2004, Galnaftogaz's share grew from 4.7% in 2004 to 6.9% in 2006.*

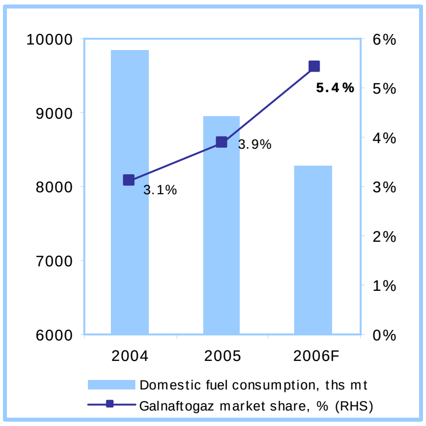
* Galnaftogaz's market share was calculated as the share of its retail sales in consumption. Therefore, this measure should not be compared to the one we used in the previous report, which was based on the number of filling stations, and is provided here to demonstrate dynamics of the company's market share.

Domestic Fuel Demand



Source: Company data, Concorde Capital estimates

GLNG's Market Share Dynamics



Source: Company data, Concorde Capital estimates

Recovery In Demand On The Way

We believe the Ukrainian fuel retail market is far from saturation and forecast demand to start recovering in 2007 on slower price growth, and also supported by a number of factors capable of shifting the whole curve:

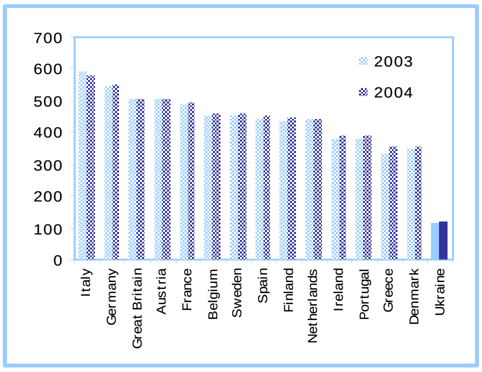
- consumer income continuing to increase
- growth in the number of cars per capita, driven by growth in incomes and easier availability of credit
- increases in the purchases of new cars over second-hand vehicles

Galnaftogaz is also likely to benefit from rising demand for high-octane and more qualitative gasoline, which offers higher retail markups. As the number of new cars increases, fewer personal cars will be using low grade gasoline.

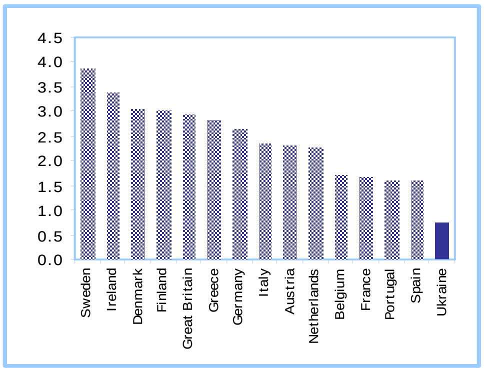
Domestic Consumption To Approach European Levels

Ukraine still lags behind European levels in fuel consumption per capita, which opens up an opportunity for fuel market players to capitalize on deferred demand.

Passenger Cars per 1000 People



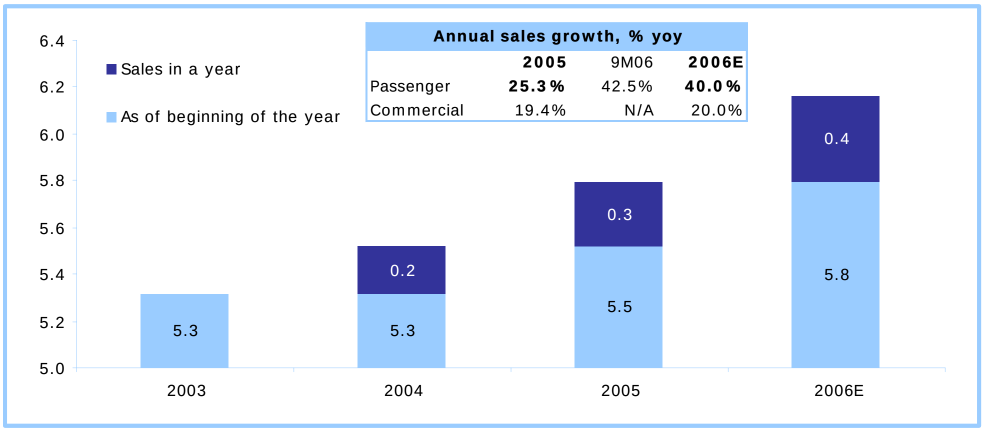
Fuel Consumption per Capita, bbl/year



Source: Company data, ANFAC (Asociación Española de Fabricantes de Automóviles y Camiones)

Compared to developed countries, in Ukraine there were only 118 personal cars per 1000 inhabitants in 2004. Recent developments indicate that the car market is in a high growth stage. Annual passenger car sales increased by 25.3% yoy, from 211.9 ths in 2004 to 265.5 ths cars in 2005, while in 9M06, sales growth was even stronger: 42.5% yoy. We expect passenger car sales to gain 40% yoy in 2006, resulting in cumulative growth of the passenger cars by 16% since 2003.

Ukrainian Passenger Cars, mln vehicles



Source: Company data, Concorde capital estimates

Market Regulation Brings More Risks

In order to stabilize domestic fuel prices, the government agreed with domestic fuel producers on price caps. In exchange, the government promised to protect them with import duties on fuel. Although duties have not been imposed so far, there is a big chance that the government will impose them next year.

We believe that import duties, if implemented, will hurt the profitability of independent retailers including Galnaftogaz, which imports about 40% of its fuel resources. Even if retailers address the risk of squeezing margins by shifting to domestically produced fuel, this is not likely to bring relief, due to higher sellers' power in the Ukrainian market.

Price Caps Did No Harm - Yet

Although the agreement is not legally enforceable, the largest Ukrainian retail chains reduced fuel prices to the agreed level. No immediate effects have been visible so far, because the price caps have been set at a fair level. Since currently fuel prices are adjusting downward on the oil price correction, the caps have not had any effect. We think the government will continue to keep a close eye on retail prices, capping them from time to time to prevent sharp peaks during temporary deficits or seasonally higher consumption.

Fuel Import Duties To Return?

In return for capping retail prices, fuel producers were promised import fuel duties, which represent another threat to non-integrated retailers. The size of the duties was not disclosed, but we do not expect them to exceed USD 20-25 per mt (~USD 0.032/L). Previous import duties for oil products were cancelled in May 2005, but before that they were about EUR 15-40/mt.

On average, the reintroduction of the duties is unlikely to spur fuel prices significantly. However, they will hurt profitability, with the effect unevenly distributed between market participants. Domestic fuel producers will benefit from lower competition from imports and higher margins. In contrast, independent retailers, such as Galnaftogaz, will have to accommodate extra costs with markups in order to retain their market shares. In the worst case, gross margins in retail may decrease by around 1 p.p.

Below is an example of the effect of import duties on profitability in retail based on gasoline price projections for 2007 under the worst case scenario, which assumes that the market does not pass the duties onto retail prices. We estimate that if and Galnaftogaz continues purchasing 40% of its products abroad, its absolute gasoline markup will be 10.1% lower than our forecast. The relative gasoline margin will also be lower (9.7% instead of the currently expected 10.8%). We have already captured this risk through conservative assumptions about Galnaftogaz’s retail margins in 2007 and beyond.

The Effect of Duties on Gasoline Prices and Margin

(absolute figures in USD/mt)

	Integrated retailers	**Independent retailers** (e.g., GLNG)
<u>The effect on wholesale price</u>:		
Wholesale price (assumption: domestic=import)	813	813
Import duty	25	25
Wholesale price (imports, incl. duty)	839	839
Share of imported products in sales	20%	40%
Weighted average wholesale price after duty introduction	**819**	**824**
<u>The effect on retail markup and margin</u>:		
Before introduction of duties:		
Retail price	**912**	**912**
Retail markup	98	98
Margin	**10.8%**	**10.8%**
After introduction of duties:		
Retail price	**912**	**912**
Retail markup	94	89
% change	*-5.1%*	*-10.1%*
Margin	***10.3%**	**9.7%**

** Note that an integrated retailer importing only 20% of its products would suffer less, retaining 10.3% margin.*
Source: Concorde Capital calculations

M&A Opportunities To Emerge

While foreign corporations have already penetrated into other sectors of the Ukrainian economy including retail, foreign ownership in fuel retail businesses remains insignificant. Ukraine's growing fuel retail market is becoming attractive for global oil majors. We believe enough prerequisites are present for intensified M&A activity.

The most significant restrictions to investment have decreased in the last three years. First, the businesses grew in size to the level material for a potential buyer. Second, compared to 90s, the structure and operations of retail businesses have become much more transparent. Local businesses tend to consolidate their assets into clearer structures and have started paying more attention to their value. The consolidation process is in its early stage, as small regional retailers hold more than 50% share of Ukrainian market. By comparison, in neighboring Turkey, small companies hold only a 5% share of retail sales.

Now, we are witnessing the first signs of interest from global corporations in the Ukrainian market. Recently, the world's largest fuel retailer, Royal Dutch/Shell Group, began selling oil products in Ukraine under its own brand. Shell signed an agreement with the Russian Alliance Group, which controls a refinery and a network of 140+ filling stations in Ukraine, to switch several of Alliance's stations to the Shell brand. These stations will continue selling oil products supplied by Alliance, which is mainly imported from Russia.

We believe that Shell is quite likely to buy out both the Kherson Refinery and the Alliance's retail network, similar to its acquisition of Turkas, a Turkish oil refinery and fuel retail company. Noteworthy, four out of ten largest Turkish downstream companies are already owned or affiliated with global majors (Shell, BP, Total and OMV).

If Shell indeed decides to stay for long, it is likely to form its own nation-wide network. Regardless of whether it opts to build stations from scratch, buy out small networks or both, its success will attract other majors. We think it won't be long until bids for local retailers appear. Please see the "Valuation" section for the details on Galnaftogaz's valuation based on the value of its assets and on the acquisitions of comparable companies.

Valuation

Unmet expectations led us to decrease our 12M target to USD 0.0110 per share (USD 5.0 per ADR), which still offers a 10% upside. We downgrade our recommendation from BUY to HOLD.

Our valuation is based on an arsenal of valuation methods: peer comparison, DCF, comparable deals and asset-based valuation. We attached more weight to the DCF, which does a better job of capturing long-term growth.

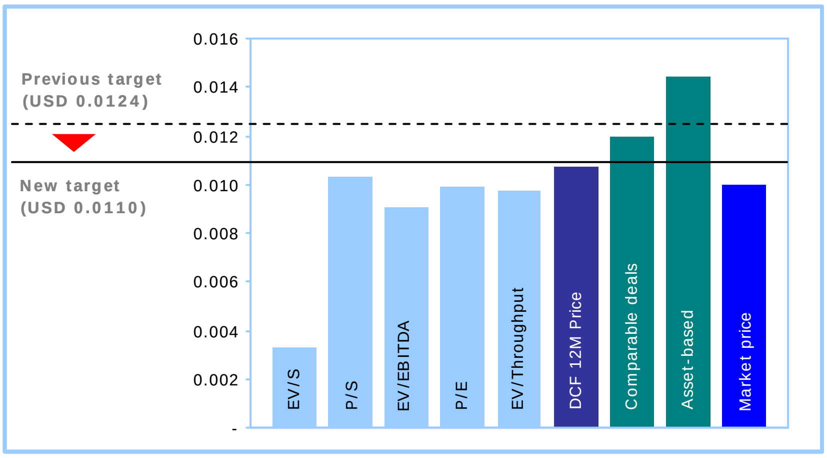
Comparable deals and the asset-based methods provide other valuation angles, accounting for the possibility of a sellout to a strategic investor. These methods reveal a significant premium of about 20-40% to the current price. Although we do not foresee a sale in the next 12 months, we strongly believe the possibility of a sale should be factored into Galnaftogaz's valuation.

Valuation summary

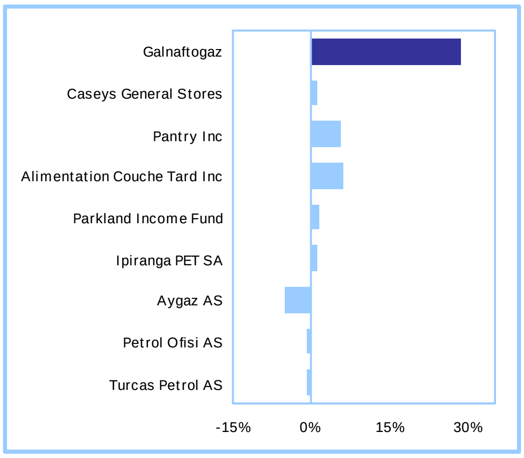
	Implied price per share, USD	Implied capitalization, USD mln
Peer comparison	0.0095	152
DCF	0.0105	172
Comparable deals	0.0120	192
Asset-based valuation	0.0144	230
12M Target	**0.0110**	**176**

Source: Concorde Capital estimates

Galnaftogaz Value-Meter, USD Per Share



Sales Growth '07, GLNG vs Peers

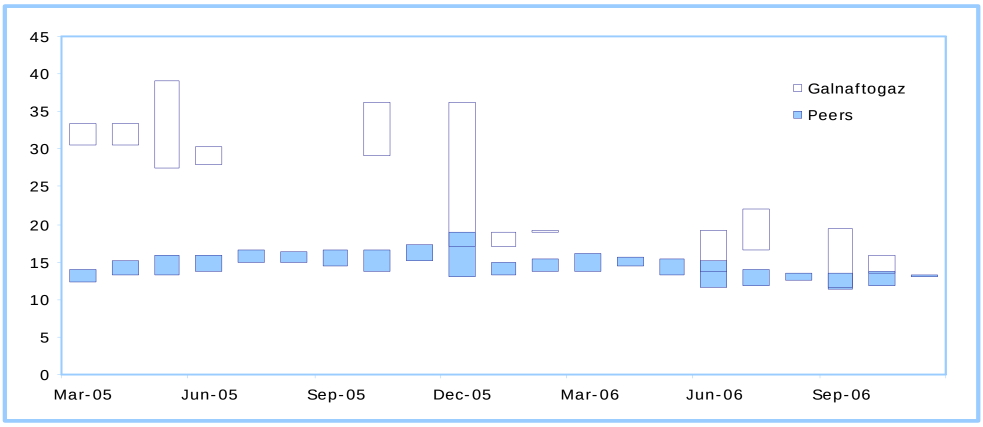


Source: Concorde Capital estimates, PFTS

Peer Comparison

It looks like the convergence of Ukrainian oils to their international peers is currently in its final stage. Similar to Ukrnafta (UNAF), GLNG has reached a level fairly close to its peers' average, as gauged by historical P/E ratios.

Galnaftogaz Historical P/E Ranges vs. Peer Average*



** P/E ranges are based on the monthly average P/E maximums and minimums*
Source: Bloomberg, Concorde Capital calculations

Galnaftogaz's EV/EBITDA and P/E multiples calculated on the basis of the 2007 forecast suggest the stock is valued fairly by the market. All of them yielded similar results and imply GLNG's price at about USD 0.0095/share. We also started using the EV/Throughput multiple, which implies a share price of USD 0.0097 and supports the price suggested by other multiples.

Mixed signals sent by the EV/S and P/S are explained by Galnaftogaz's considerable leverage compared to its peers. We believe that the large debt is well justified, as the company remains in a rapid growth phase, which is captured by a PEG ratio seven times lower than its peers.

Peer Valuation Summary

		MCap, USD mln	EV/S		P/S		EV/EBITDA		P/E		PEG Ratio		EV/Throughput
			2006F	2007F	2006F	2007F	2006F	2007F	2006F	2007F	2006F	2007F	2005
Galnaftogaz	**Ukraine**	**160**	0.48	**0.45**	0.31	**0.24**	8.89	**7.40**	16.01	**12.04**	41.0	**36.5**	**0.57**
Caseys General Stores	United States	1 178	0.31	0.30	0.30	0.30	7.06	6.48	16.87	15.04	26.3	123.7	0.42
Pantry Inc	United States	1 001	0.27	0.23	0.17	0.16	6.09	5.41	13.01	12.86	39.3	1098.3	0.39
Alimentation Couche Tard Inc	Canada	4 418	0.41	0.40	0.39	0.37	8.96	8.42	19.49	17.01	45.8	116.6	0.75
Parkland Income Fund	Canada	343	0.33	0.32	0.32	0.32	6.93	9.04	8.11	12.28	8.3	neg	0.76
Ipiranga PET SA	Brasil	797	0.14	0.13	0.08	0.08	6.41	5.98	5.07	5.88	39.6	neg	0.45
Aygaz AS	Turkey	558	0.31	0.30	0.17	0.18	5.92	5.49	7.42	10.05	58.8	neg	0.59
Petrol Ofisi AS	Turkey	1 574	0.21	0.18	0.17	0.17	5.06	4.07	10.53	7.46	neg	18.2	0.45
Turcas Petrol AS	Turkey	643	0.44	0.45	0.44	0.44	11.43	11.27	18.16	15.02	636.1	71.9	0.67
Mean			0.30	**0.29**	0.26	**0.25**	7.23	**7.02**	12.33	**11.95**	122.0	**285.8**	**0.56**
Implied price			0.0044	**0.0033**	0.0081	**0.0103**	0.0072	**0.0091**	0.0077	**0.0099**	0.0298	**0.0783**	**0.0097**
Upside/Downside			-56%	**-67%**	-19%	**3%**	-28%	**-9%**	-23%	**-1%**	198%	683%	-3%

		EBITDA Margin		Net Margin		Sales Growth	
		2006F	2007F	2006F	2007F	2006F	2007F
Galnaftogaz	**Ukraine**	5.4%	**6.1%**	2.0%	**2.0%**	34.3%	**28.6%**
Caseys General Stores	United States	4.5%	4.7%	1.8%	2.0%	40.5%	1.1%
Pantry Inc	United States	4.4%	4.2%	1.3%	1.2%	33.6%	5.8%
Alimentation Couche Tard Inc	Canada	4.5%	4.8%	2.0%	2.2%	38.8%	5.9%
Parkland Income Fund	Canada	4.7%	3.6%	4.0%	2.6%	41.8%	1.4%
Ipiranga PET SA	Brasil	2.1%	2.2%	1.6%	1.4%	18.3%	1.0%
Aygaz AS	Turkey	5.2%	5.4%	2.3%	1.8%	4.7%	-5.0%
Petrol Ofisi AS	Turkey	4.2%	4.5%	1.6%	2.3%	7.5%	-0.9%
Turcas Petrol AS	Turkey	3.9%	4.0%	2.4%	3.0%	6.2%	-1.0%
Mean		4.2%	**4.2%**	2.1%	**2.0%**	23.9%	**1.0%**

Source: Concorde Capital estimates

DCF Valuation

Our DCF valuation gives GLNG's fair value per share at USD 0.0107, which implies a 7% upside from the current market price.

Compared to our previous model, the major changes to our assumptions were:

- we downgraded our assumptions about Galnaftogaz's profitability;

- we assumed higher fuel prices in absolute terms for 2007-2015, to reflect higher prices in 2005-2006 and the assumption that the prices will gradually continue to grow, driven by domestic inflation and global oil trends;

- we accounted for more ambitious expansion plans by revising the assumed number of stations upward in perpetuity, since our previous assumption (291) now looks too conservative. Galnaftogaz's management also provided us with their recent CapEx projections, which imply higher per-station investments and other expenditures. We revised CapEx assumptions upward;

- we have recalibrated GLNG's model by implementing changes to our methodology for calculating the WACC, as well as for new estimates of equity premiums for Ukrainian stocks (see our strategy report from March 2006). As a result, Galnaftogaz's yearly WACCs were reduced by around 1 p.p.

Please refer to Appendix 1 for a summary of revised forecasts.

Discounted Cash Flow Valuation

Valuation date: Nov. 9, 2007

We use local currency for our forecasts (UAH mln)

	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
EBITDA	**137**	**200**	**281**	**363**	**417**	**445**	**458**	**469**	**477**	**486**
EBIT	106	146	192	243	285	306	315	319	317	318
Tax Rate	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*
Taxed EBIT	80	109	144	182	214	230	236	239	238	239
Plus D&A	31	55	89	120	132	139	144	151	160	168
Less CapEx	-273	-374	-390	-312	-221	-159	-159	-161	-167	-170
Less change in OWC	-45	-13	-58	-47	-38	-20	-18	-10	-1	0
FCFF	**-**	**-223**	**-215**	**-57**	**87**	**189**	**203**	**219**	**230**	**237**
WACC	11.2%	10.7%	9.5%	8.9%	8.7%	8.8%	9.4%	9.9%	10.4%	11.0%
WACC To Perpetuity										**11.0%**
Terminal Value										2 685

Firm Value	**1 503**	PV of Terminal Value	1 275
Less Net Debt	-644	**Portion due to TV**	**84.8%**
Equity Value	**859**	Perpetuity Growth Rate	2.0%
12M Fair Value per Share, UAH	**UAH 0.0537**	Implied Exit EBITDA Multiple	5.5x
12M Fair Value per Share, USD	**USD 0.0105**	**Target Capitalization, USD mln**	**USD 168.6 mln**

Source: Concorde Capital estimates

Sensitivity of fair value per share, USD

10-Year Discount Rates	Perpetuity Growth Rate				
	1.0%	***1.5%***	***2.0%***	***2.5%***	***3.0%***
WACC – 1.5%	0.0111	0.0120	0.0130	0.0142	0.0154
WACC – 1.0%	0.0103	0.0112	0.0122	0.0133	0.0145
WACC – 0.5%	0.0096	0.0104	0.0113	0.0124	0.0135
WACC + 0.0%	0.0088	0.0096	**0.0105**	0.0115	0.0127
WACC + 0.5%	0.0081	0.0089	0.0098	0.0107	0.0118
WACC +1.0%	0.0075	0.0082	0.0090	0.0100	0.0110
WACC + 1.5%	0.0068	0.0075	0.0083	0.0092	0.0102

WACC to perpetuity	Perpetuity Growth Rate				
	1.0%	***1.5%***	***2.0%***	***2.5%***	***3.0%***
9.5%	0.0111	0.0122	0.0134	0.0148	0.0165
10.0%	0.0102	0.0112	0.0123	0.0136	0.0150
10.5%	0.0095	0.0104	0.0114	0.0125	0.0138
11.0%	0.0088	0.0096	**0.0105**	0.0115	0.0127
11.5%	0.0082	0.0090	0.0098	0.0107	0.0117
12.0%	0.0077	0.0084	0.0091	0.0099	0.0108
12.5%	0.0072	0.0078	0.0085	0.0092	0.0101

Source: Concorde Capital estimates

Comparable Deals

In May of this year, OMV AG, the Austrian oil and gas company, completed the acquisition of a 34% stake in Petrol Ofisi AS (POAS), the Turkish distributor of petroleum products, from Dogan Holding, the Turkish diversified investment holding company, for a consideration of USD 1,054 mln.

Petrol Ofisi currently operates 3,600 filling stations in Turkey. It recorded sales of USD 6.56 bln in the first nine months of 2005 and employs approximately 1,000 people. Its total fuel sales volume was approximately 8.1 mln mt in 2005, and is expected to increase to 10.3 mln mt by 2015. It also owns 800 ths cm of storage facilities, representing 29% of Turkey's total storage capacity.

As the table below demonstrates, POAS' EV/EBITDA ratios calculated at the deal price suggest only a slight upside for Galnaftogaz's stock, while P/S and P/E multiples promise a 22-36% premium. The largest upside is implied by the EV/Throughput multiple, though it should be perceived with a discount as POAS' annual throughput excludes considerable wholesale operations.

We take Galnaftogaz's price implied by the OMV/POAS deal at a discount to account for the fact that POAS, holding a 35% market share, is a much more powerful retail player in the Turkish market than Galnaftogaz is in Ukrainian Ukraine. However, since Galnaftogaz is growing much faster, the discount is not very big.

We think that USD 0.0120 per share is a reasonable price for GLNG stock based on the OMV/POAS deal.

Galnaftogaz Valuation Based On OMV / POAS deal

		MCap, USD mln	EV / S		P / S		EV / EBITDA		P / E		PEG Ratio		EV / Throughput
			2006F	2007F	2006F	2007F	2006F	2007F	2006F	2007F	2006F	2007F	2005
Galnaftogaz	Ukraine	160	0.48	0.45	0.31	0.24	8.89	7.40	16.01	12.04	41.0	36.5	0.57
Petrol Ofisi AS	Turkey	3 100	0.37	0.35	0.33	0.33	8.94	7.72	20.74	14.70	neg	18.2	0.76
Implied price			0.0067	0.0056	0.0105	0.0136	0.0101	0.0108	0.0130	0.0122	n/a	0.0098	0.0141
Upside/Downside			-33%	-44%	5%	36%	1%	8%	30%	22%	n/a	-2%	41%

Source: Mergermarket, Thomson Financial, Concorde Capital estimates

Asset-based Valuation

After investigating a number of 2005-06 M&A deals in the fuel retail sector from around the world, we found that the price of one fuel station can be approximated at USD 0.9 mln. This estimate implies a fair value for Galnaftogaz of about USD 230 mln, based on the targeted number of stations in 2007 (256), and a 44% upside. The USD 0.9 mln per station is a fairly rough estimation, but we believe it is quite conservative.

Rumor has it that Kontinium, a Ukraine-based business group, recently bought 16 filling on southern Ukraine for USD 19.0 mln, which is USD 1.2 mln per station.

We believe that the value of Galnaftogaz's filling stations, fuel depots, vehicles and other assets, is more than USD 230 mln, but we intentionally limited our estimate to account for the possibility that the 2007 target of 256 stations might not be achieved and to reflect the fact that around half of the company's PPE is pledged to the banks.

Recent Deals In Fuel Retail

Announced	Completed	Target	Bidder	Seller	# of retail outlets [to be] acquired	Deal value, USD mln	Average value of 1 outlet, USD mln	Country	Description
Jun-06	Jul-06	Fast Petroleum Inc	MAPCO Express Inc	Fast Petroleum Inc	40	40.0	1.0	United States	MAPCO Express Inc, the US based operator of gas stations, acquired 40 US based retail fuel and convenience stores from Fast Petroleum Inc, the US based operator of supermarkets and grocery stores, for a cash consideration of USD 40 mln.
Jun-06	Jun-06	Mobil Oil de Peru SA	Repsol Comercial SAC	Mobil Oil de Peru SA	70	27.5	0.4	Peru	Repsol Comercial SAC, the Peru based gasoline service stations company, has acquired 70 gas stations from Mobil Oil de Peru SA, for USD 27.5 mln. The new purchase will increase Repsol's number of gas stations in Peru to 220.
May-06	n/a	Sonol Israel Ltd	Oil Refineries Ltd	Dor Alon Energy in Israel (1988) Ltd	70	51.4	0.7	Israel	Oil Refineries Ltd (ORL), the Israel based company involved in refining of crude oil, has agreed to acquire 70 Sonol gas stations from Dor Alon Energy in Israel Ltd, the Israel based gasoline company, for a cash consideration USD 51.4 mln. The agreement provides ORL with an option to acquire 10 more gas stations.
Apr-06	Apr-06	Novaia Sigma; Sigma Opt	Petersburg Fuel Company (PTK)	n/a	17	20.0	1.2	Russia	Petersburg Fuel Company (PTK), the Russian fuel stations owner and operator, has agreed to acquire Novaia Sigma and Sigma Opt, the Russian fuel stations, from undisclosed private investors, for an estimated consideration of USD 20 mln. The acquired businesses jointly own 17 filling stations in Novgorod along with fuel storage facility with storage capacity of 5000 tons.
Mar-06	n/a	Caprabo SA	Saras Energia S.A	Caprabo SA	37	38.7	1.0	Spain	Saras Energia S.A, the Spanish petrol station operator, has agreed to acquire 37 petrol stations of Caprabo SA, the Spanish supermarket group, for a consideration of EUR 32.2 mln.
Dec-05	n/a	Royal Dutch Shell Group (fuel business in Columbia, Paraguay and Uruguay)	Petroleo Brasileiro SA	Royal Dutch Shell Group	261	140.0	0.5	Columbia, Paraguay, Uruguay	Petroleo Brasileiro SA (Petrobras), the Brazil based integrated energy company, has agreed to acquire its operations in Uruguay, and Paraguay, and fuel business in Columbia, from Royal Dutch Shell Group, the listed Anglo-Dutch energy and petrochemicals company, for a consideration of USD 140 mln. Petrobras will acquire 38, 89, and 134 gas stations in Columbia, Uruguay, and Paraguay respectively.

Source: Mergermarket

Appendix 1. Forecast Revision Summary

	2005E	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Number of stations	177	218	256	291	291	291	291	291	291	291	n/a
OKKO	124	175	221	265	265	265	265	265	265	265	n/a
Other	53	43	35	26	19	12	5	0	0	0	n/a
Increase in # of stations	13	41	38	35	-7	-7	-7	-5	0	0	n/a
Avg daily throughput per station, mt	5.89	6.36	7.69	8.64	9.64	10.18	10.76	11.19	11.49	11.49	n/a
Total OP retailed, ths mt	380.5	506.3	718.8	920.2	999.0	1029.1	1060.2	1085.3	1111.1	1111.1	n/a
Avg retail price, USD/L (gross)	0.640	0.659	0.673	0.686	0.700	0.707	0.714	0.721	0.728	0.735	n/a
Net Revenues	319	390	560	729	809	846	884	919	956	974	n/a
Change yoy	*32%*	*22%*	*44%*	*30%*	*11%*	*4%*	*5%*	*4%*	*4%*	*2%*	n/a
Gross Margin	*8%*	*10%*	*10%*	*10%*	*10%*	*9%*	*9%*	*8%*	*8%*	*8%*	n/a
EBITDA	18	32	46	60	65	61	55	51	50	50	n/a
EBITDA margin	5.7%	8.1%	8.1%	8.2%	8.0%	7.2%	6.2%	5.5%	5.2%	5.1%	n/a
Net Income	8	15	23	33	36	35	32	29	29	29	n/a
Net Margin	*2.4%*	*3.9%*	*4.1%*	*4.5%*	*4.5%*	*4.1%*	*3.6%*	*3.2%*	*3.0%*	*3.0%*	n/a
Net Debt/Equity	71%	80%	73%	54%	30%	16%	8%	4%	2%	-1%	n/a
ROIC	15.9%	20.7%	22.5%	23.5%	21.0%	18.8%	16.3%	14.5%	14.0%	13.7%	n/a
WACC	14.1%	13.6%	13.1%	13.0%	13.4%	13.4%	13.3%	12.6%	12.2%	12.3%	n/a
Capital Expenditures, net	(27)	(34)	(32)	(30)	(9)	(9)	(9)	(8)	(8)	(8)	n/a
Current Ratio	1.29	1.33	1.32	1.36	1.40	1.48	1.51	1.48	1.58	1.58	n/a
Fin Leverage Multiplier	2.40	2.44	2.45	2.32	2.08	1.86	1.73	1.66	1.63	1.60	n/a

November 2006 Model

	2005	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Number of stations	176	212	256	291	316	325	325	325	325	325	325
OKKO	115	160	219	274	309	325	325	325	325	325	325
Other	61	52	37	17	7	0	0	0	0	0	0
Increase in # of stations	17	36	44	35	25	9	0	0	0	0	0
Avg daily throughput per station, mt	5.72	6.34	7.29	8.71	9.56	10.09	10.50	10.70	10.90	11.00	11.05
Total OP retailed, ths mt	347.7	444.0	614.8	863.3	1 053.1	1 177.2	1 245.6	1 272.8	1 293.0	1 304.9	1 310.8
Avg retail price, USD/L (gross)	0.641	0.808	0.841	0.865	0.892	0.916	0.936	0.954	0.972	0.991	1.010
Net Revenues	380	507	645	905	1 122	1 280	1 380	1 434	1 482	1 523	1 558
Change yoy	*57.3%*	*33.6%*	*27.3%*	*40.2%*	*24.0%*	*14.1%*	*7.8%*	*3.9%*	*3.4%*	*2.7%*	*2.3%*
Gross Margin	*6.8%*	*7.3%*	*7.5%*	*7.3%*	*7.1%*	*7.0%*	*7.0%*	*6.9%*	*6.9%*	*6.8%*	*6.8%*
EBITDA	16	27	40	55	71	82	87	90	92	94	95
EBITDA margin	*4.2%*	*5.4%*	*6.1%*	*6.1%*	*6.3%*	*6.4%*	*6.3%*	*6.3%*	*6.2%*	*6.1%*	*6.1%*
Net Income	7	10	13	18	24	30	34	36	38	40	43
Net Margin	*1.9%*	*2.0%*	*2.0%*	*2.0%*	*2.1%*	*2.3%*	*2.4%*	*2.5%*	*2.6%*	*2.7%*	*2.8%*
Net Debt/Equity	63%	116%	160%	184%	168%	133%	95%	67%	45%	26%	11%
ROIC	13.4%	14.3%	13.4%	12.8%	12.3%	12.5%	12.5%	12.5%	12.5%	12.2%	12.2%
WACC	9.9%	11.2%	10.7%	9.5%	8.9%	8.7%	8.8%	9.4%	9.9%	10.4%	11.0%
Capital Expenditures, net	(18)	(54)	(74)	(77)	(61)	(43)	(31)	(31)	(31)	(33)	(33)
Current Ratio	1.21	1.42	1.30	1.31	1.32	1.34	1.17	1.11	1.11	1.34	1.56
Fin Leverage Multiplier	2.66	2.74	2.98	3.26	3.25	2.93	2.51	2.13	1.84	1.61	1.41

Appendix 2. Financial Statements According To IFRS

Income Statement Summary, USD mln

	2004	2005	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Net Revenues	**241**	**380**	**507**	**645**	**905**	**1 122**	**1 280**	**1 380**	**1 434**	**1 482**	**1 523**	**1 558**
Change y-o-y	*N/M*	*57.3%*	*33.6%*	*27.3%*	*40.2%*	*24.0%*	*14.1%*	*7.8%*	*3.9%*	*3.4%*	*2.7%*	*2.3%*
Cost Of Sales	(227)	(354)	(470)	(597)	(838)	(1 042)	(1 190)	(1 284)	(1 335)	(1 381)	(1 419)	(1 453)
Gross Profit	14	26	37	48	66	80	90	96	99	102	103	105
Other Operating Income/Expenses, net	0	(1)	-	-	-	-	-	-	-	-	-	-
SG&A	(6)	(9)	(10)	(9)	(11)	(9)	(8)	(9)	(9)	(10)	(10)	(10)
EBITDA	**8**	**16**	**27**	**40**	**55**	**71**	**82**	**87**	**90**	**92**	**94**	**95**
EBITDA margin, %	*3.5%*	*4.2%*	*5.4%*	*6.1%*	*6.1%*	*6.3%*	*6.4%*	*6.3%*	*6.3%*	*6.2%*	*6.1%*	*6.1%*
Depreciation	(3)	(4)	(6)	(11)	(17)	(23)	(26)	(27)	(28)	(30)	(31)	(33)
EBIT	**6**	**12**	**21**	**29**	**38**	**48**	**56**	**60**	**62**	**62**	**62**	**62**
EBIT margin, %	*2.4%*	*3.2%*	*4.2%*	*4.4%*	*4.2%*	*4.2%*	*4.4%*	*4.3%*	*4.3%*	*4.2%*	*4.1%*	*4.0%*
Interest Expense	(3)	(3)	(8)	(11)	(14)	(16)	(16)	(15)	(14)	(11)	(8)	(5)
Financial Income	1	0	-	-	-	-	-	-	-	-	-	-
Other income/(expense)	-	-	-	-	-	-	-	-	-	-	-	-
PBT	**4**	**9**	**13**	**17**	**24**	**32**	**39**	**45**	**48**	**51**	**54**	**57**
Tax	(1)	(2)	(3)	(4)	(6)	(8)	(10)	(11)	(12)	(13)	(13)	(14)
Effective tax rate	*30%*	*21%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*
Net Income	**2**	**7**	**10**	**13**	**18**	**24**	**30**	**34**	**36**	**38**	**40**	**43**
Net Margin, %	*1.0%*	*1.9%*	*2.0%*	*2.0%*	*2.0%*	*2.1%*	*2.3%*	*2.4%*	*2.5%*	*2.6%*	*2.7%*	*2.8%*
Dividend Declared	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

Balance Sheet Summary, USD mln

	2004	2005	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Current Assets	**34**	**79**	**69**	**69**	**90**	**105**	**118**	**126**	**131**	**135**	**137**	**139**
Cash & Equivalents	3	3	7	3	2	2	2	1	2	2	2	2
Trade Receivables	17	47	19	19	27	30	33	35	36	37	37	37
Inventories	6	14	28	39	54	68	77	83	87	90	92	93
Other current assets	9	14	15	8	7	6	6	6	7	7	7	7
Non-Current Assets	**54**	**84**	**132**	**193**	**251**	**289**	**306**	**310**	**313**	**317**	**319**	**321**
PP&E, net	43	65	106	167	233	273	294	304	307	309	310	310
Other Non-Current Assets	11	18	26	26	19	15	12	6	6	8	9	11
Total Assets	**88**	**163**	**200**	**261**	**342**	**394**	**425**	**436**	**444**	**452**	**456**	**460**
Shareholders' Equity	**37**	**61**	**71**	**83**	**101**	**125**	**154**	**188**	**224**	**263**	**303**	**346**
Share Capital	28	32	33	33	33	33	33	33	33	33	33	33
Reserves and Other	8	29	38	50	68	92	121	155	191	229	270	313
Current Liabilities	**26**	**66**	**48**	**53**	**69**	**80**	**88**	**108**	**118**	**122**	**102**	**89**
ST Interest Bearing Debt	4	11	10	13	18	22	26	41	50	52	30	16
Trade Payables	21	31	28	36	49	56	62	65	67	69	71	73
Accrued Wages	-	-	-	-	-	-	-	-	-	-	-	-
Accrued Taxes	-	0	-	-	-	-	-	-	-	-	-	-
Other Current Liabilities	1	24	10	4	2	1	1	1	1	1	1	1
LT Liabilities	**25**	**36**	**81**	**125**	**171**	**190**	**182**	**140**	**102**	**68**	**51**	**25**
LT Interest Bearing Debt	24	31	79	124	170	189	181	139	101	67	50	24
Other LT	2	5	2	1	1	1	1	1	1	1	1	1
Total Liabilities & Equity	**88**	**163**	**200**	**261**	**342**	**394**	**425**	**436**	**444**	**452**	**456**	**460**

Exchange Rates, UAH / USD

	2004	2005	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Average	5.32	5.12	5.05	5.08	5.10	5.10	5.10	5.10	5.10	5.10	5.10	5.10
Year-end	5.31	5.05	5.05	5.10	5.10	5.10	5.10	5.10	5.10	5.10	5.10	5.10

Financial Statements According To IFRS (Cont'd)

Cash Flow Statement Summary, USD mln

	2004	2005	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Net Income	2	7	10	13	18	24	30	34	36	38	40	43
Depreciation	3	4	6	11	17	23	26	27	28	30	31	33
Non-operating and non-cash items	(5)	(1)	3	(0)	0	0	(0)	(0)	(0)	(2)	(1)	(1)
Less Changes in working capital	0	(28)	(9)	(3)	(11)	(9)	(7)	(4)	(4)	(2)	(0)	0
Operating Cash Flow	**0**	**(19)**	**11**	**21**	**24**	**38**	**48**	**57**	**61**	**64**	**71**	**75**
Capital Expenditures, net	(11)	(18)	(54)	(74)	(77)	(61)	(43)	(31)	(31)	(31)	(33)	(33)
Other Investments, net	(1)	(1)										
Investing Cash Flow	**(12)**	**(19)**	**(54)**	**(74)**	**(77)**	**(61)**	**(43)**	**(31)**	**(31)**	**(31)**	**(33)**	**(33)**
Net Borrowings/(repayments)	10	13	47	48	52	23	(5)	(26)	(30)	(33)	(38)	(41)
Dividends Paid	-	-	-	-	-	-	-	-	-	-	-	-
Other	3	26	-	-	-	-	-	-	-	-	-	-
Financing Cash Flow	**12**	**39**	**47**	**48**	**52**	**23**	**(5)**	**(26)**	**(30)**	**(33)**	**(38)**	**(41)**
Beginning Cash Balance	N/A	1	3	7	3	2	2	2	1	2	2	2
Ending Cash Balance	3	3	7	3	2	2	2	1	2	2	2	2
Net Cash Inflows/Outflows	**1**	**1**	**4**	**(4)**	**(1)**	**(0)**	**(0)**	**(0)**	**0**	**0**	**(0)**	**0**

Ratio Analysis and Per Share Data

	2004	2005	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Liquidity Ratios												
Current Ratio	1.30	1.21	1.42	1.30	1.31	1.32	1.34	1.17	1.11	1.11	1.34	1.56
Receivables Collection DOH (est.)	n/a	45	24	11	9	9	9	9	9	9	9	9
Inventories Processing DOH (est.)	n/a	14	16	20	20	21	22	22	23	23	23	23
Payment Period (est.)	n/a	31	23	20	18	18	18	18	18	18	18	18
Cash Conversion Cycle	n/a	28	17	11	11	12	13	13	14	14	14	13
Operating Efficiency Ratios												
Total Asset Turnover	2.74	2.33	2.79	2.80	3.00	3.05	3.13	3.21	3.26	3.31	3.35	3.40
Fixed Asset Turnover	4.45	4.53	4.71	3.98	4.08	4.16	4.31	4.48	4.60	4.71	4.79	4.87
Operating Profitability Ratios												
Operating Profit Margin	2%	3%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Net Margin	1%	2%	2%	2%	2%	2%	2%	2%	3%	3%	3%	3%
ROE	7%	12%	15%	17%	19%	21%	21%	20%	18%	16%	14%	13%
Financial Risk Ratios												
Debt-to-Equity Ratio	74.8%	68.6%	125.2%	163.4%	186.1%	169.1%	133.7%	96.2%	67.5%	45.2%	26.7%	11.4%
Total Debt-to-Assets Ratio	0.58	0.62	0.64	0.68	0.70	0.68	0.64	0.57	0.49	0.42	0.34	0.25
Interest Coverage	2.1	3.5	2.7	2.6	2.7	3.0	3.4	3.9	4.6	5.5	7.4	12.4
Du Pont Analysis												
Net Margin	1.0%	1.9%	2.0%	2.0%	2.0%	2.1%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%
Total Asset Turnover	2.74	2.33	2.79	2.80	3.00	3.05	3.13	3.21	3.26	3.31	3.35	3.40
Fin Leverage Multiplier	2.40	2.66	2.74	2.98	3.26	3.25	2.93	2.51	2.13	1.84	1.61	1.41
ROE = NM x TAT x FLM	6.8%	11.7%	15.0%	16.9%	19.2%	20.9%	21.2%	19.6%	17.5%	15.8%	14.3%	13.3%
Per Share Data, USD												
EPS	0.000	0.001	0.001	0.001	0.001	0.001	0.002	0.002	0.002	0.002	0.003	0.003
DPS	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
BPS	0.003	0.005	0.006	0.006	0.006	0.008	0.010	0.012	0.014	0.016	0.019	0.022

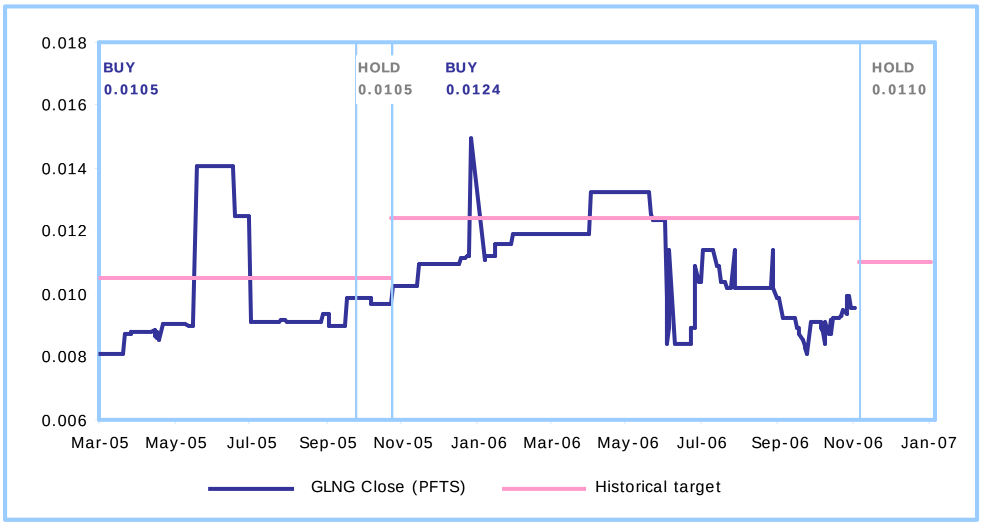
Analyst Certification

I, Vladimir Nesterenko, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Date	Target price, USD	Market price**, USD	Recommendation	Action
05 Mar 2005	0.0105	0.0081	BUY	Initiate
23 Sep 2005	0.0105	0.0100	HOLD	Downgrade
26 Oct 2005	0.0124	0.0100	BUY	Upgrade
10 Nov 2006*	0.0110	0.0100	HOLD	Downgrade

** From March 2005 to December 2005 the company was covered by Andriy Gostik, who now focuses on another sector. In January 2006, Vladimir Nesterenko took over coverage.*
*** PFTS/Frankfurt*

Recommendation History, USD



Concorde Capital Coverage Universe

Buy	38	54%
Hold	11	15%
Sell	9	13%
Pending/Suspended	5	7%
Not Rated	8	11%
Total	**71**	**100%**

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