

### Confirmation of recommendation to Buy

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Ticker	LKOH RM
Recommendation	<b>BUY</b>
Current price, ₸/share	5 450
12M target price, ₸/share	6 317
<b>Upside</b>	<b>16%</b>
Expected dividend, RUB/share	270
Expected dividend yield	5%

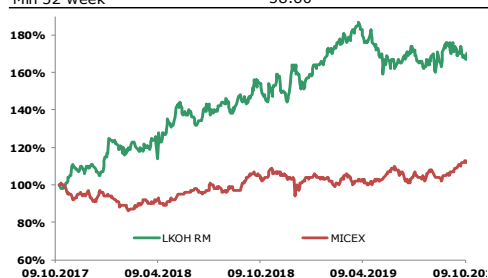
Ticker	LKOD LI
Recommendation	<b>BUY</b>
Current price, \$/share	84.30
12M target price, \$/share	97.56
<b>Upside/Downside</b>	<b>16%</b>
Expected dividend, RUB/GDR	4.2
<b>Expected dividend yield</b>	<b>5%</b>
No. of ordinary shares (mn)	715
Free float (%)	61.6%
3M av. daily turnover (P ₸ bn)	879
Market capitalisation (P ₸ bn)	3 897

Financials (P ₸ bn)	2018	2019E	2020F
Revenue	8 036	7 953	7 777
EBITDA	1 115	1 260	1 210
Net profit	621	666	712
EPS, ₸	1 305	1 398	1 496
Equity	4 074	4 546	5 052
Net debt	16	-101	-420

Valuation	2018	2019E	2020F
Net Debt/EBITDA (x)	0.01	-0.08	-0.35
Debt/Equity	0.13	0.12	0.08
EV/Sales (x)	0.49	0.48	0.45
EV/EBITDA (x)	3.51	3.01	2.87
P/E (x)	4.18	3.90	3.64

LKOH RM price dynamic	Abs.	Relative MICEX
1M	8.9%	4.6%
3M	15.2%	12.9%
6M	30.3%	34.1%
Max 52 week	5 996	
Min 52 week	2 586	

LKOD LI price dynamic	Abs.	Relative FTSE 100
1M	5.9%	2.9%
3M	12.0%	10.9%
6M	26.7%	31.6%
Max 52 week	83.28	
Min 52 week	58.60	



### We recommend to Buy Lukoil's shares with 12M TP 6317rub. per share.

We remain confident about the stability of cash flows generated by Lukoil amid continued uncertainty in the global oil market and note strong catalysts for stock growth in both the short and long terms. We expect shares to rise in the coming month due to the announcement of interim dividends and see the potential for further stock growth during the buyback period. We note the company's strong financial performance, ensured by a highly profitable oil production and a wide geography of exports, as a guarantee of a stable increase in Lukoil's market capitalization in the long term.

**Strong 1H2019 results despite weak oil market conditions.** Lukoil's statement results for 6M2019 demonstrates revenue growth of 7.9% yoy to 3 977bn rubles. EBITDA increased by 22.5% yoy to 630.2bn rubles. The growth was driven by higher sales volumes of crude oil and natural gas due to higher production volumes. The increase was also supported by the ruble devaluation resulting in higher average international prices for hydrocarbons in ruble terms, which partially offset the increase in the price of purchased crude oil by 5.7% yoy to 2.2tn rubles. Operating profit amounted to 421bn rubles (+ 28% yoy) and net profit strengthened by 20% yoy, amounting to 332bn rubles, which in our opinion is a strong result. Mostly the company's "dollar" revenue eliminates the negative effect of fluctuations of oil prices, due to which the sensitivity to the situation on energy markets for Lukoil shares is relatively lower. CFO in the reporting period increased by 25% yoy to 513bn rubles. Cash at the end of 1H2019 amounted to 506bn rubles, showing an increase of 3% since the beginning of the year and by 49% yoy. At the end of 2019, we expect EBIT to grow by 9% yoy to 841bn rubles and we see the potential to achieve a net profit level of 666bn rubles. FCF, according to our forecasts, will be positive and will reach 700bn by 2025.

**Second wave of buyback.** In August this year, Lukoil completed the \$3bn stock buyback program, planned for the period from September 2018 to December 2022. Repurchased stocks amounted to 4.96% of the authorized capital of the company. All repurchased shares were redeemed and the total number of issued ordinary shares of Lukoil decreased from 750mn to 715mn. In early October this year, Lukoil announced the launch of its second buyback program for the same amount of \$3bn, which will be sold until December 30, 2022. Given the current market price, the buyback volume of \$3bn is about 5.1% of Lukoil's authorized capital. We note mainly the positive impact of the buyback on LKOH shares, given that the offer price at the previous buyback assumed a premium to the market price of 5.4%. In addition, due to the higher EPS value and dividend per share due to buyback, Lukoil shares look even more attractive in comparison with the competitors.

**A progressive dividend policy remains relevant.** Lukoil, which has a dividend history of more than 20 years, has been continuously increasing the dividend for the last 6 years and striving to increase the dividend per share annually by at least the level of ruble inflation. Free cash flow dividend coverage ratio for 2018 amounted to 351%. At the end of last year, Lukoil allocated about a third of its net profit for payment, which corresponds to 250 rubles per share and a dividend yield of 5%. At the minimum guaranteed dividend level of 25% of net profit, according to our expectations, the company will maintain the growth of dividend per share, increasing the payout ratio if necessary. An impressive cash position with a fairly low debt burden (Debt/Equity 16% with an industry average of 37%), in our opinion, will allow the company to provide a high dividend yield. At the end of 2019 we expect an increase in the total dividend by 8% yoy to 270 rubles per share. Given that the company practices the payment of interim dividends, we expect good preconditions for the growth of shares over the next month in anticipation of the announcement of the dividend for 9M2019. Note that according to the results of 9M2018 Lukoil paid 95 rubles/share and 85 rubles/share for 9M2017. In the future, due to the ongoing buyback program, we expect a more significant increase in dividend per share.

Fig. 1. 1H2019 financial results

RUB bn	1H2018	1H2019	yoY
<b>Revenue</b>	<b>3 687</b>	<b>3 976</b>	<b>8%</b>
Operating expenses	-221	-223	1%
Cost of purchased oil	-2 079	-2 198	6%
Transportation costs	-134	-137	2%
Administrative expenses	-77	-99	29%
Depreciation and amortization	-185	-210	14%
Oil taxes	-401	-476	19%
Excise and export duties	-259	-213	-18%
Exploration costs	-1	-2	100%
<b>Operating profit</b>	<b>330</b>	<b>418</b>	<b>27%</b>
Financial income	8	12	50%
Financial expenses	-16	-23	44%
The share of profits in JV and assoc.	11	11	0%
Exchange difference	21	6	-71%
Other (expenses) income	-10	-10	0%
Profit before income tax	344	414	20%
Income tax	-67	-85	27%
<b>Net profit</b>	<b>277</b>	<b>329</b>	<b>19%</b>

Fig. 3. Smooth growth in production costs due to the continued low cost of purchased oil

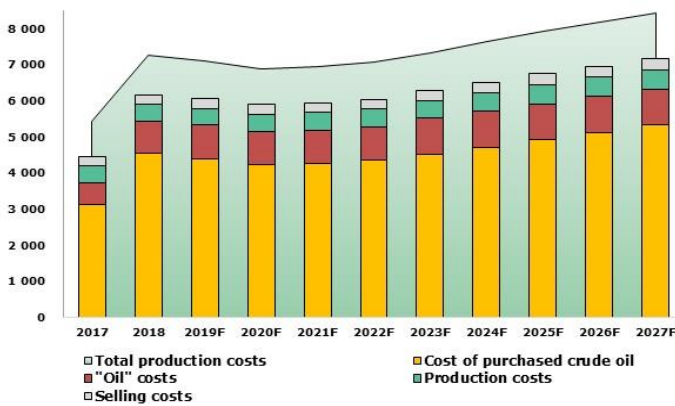


Fig. 5. Strong dividend history

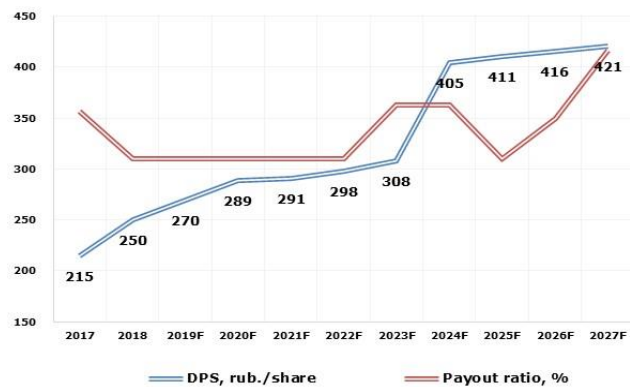


Fig. 7. The calculation of 12M target price

RUB bn	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F
<b>EBIT</b>	<b>899.430</b>	<b>900.014</b>	<b>919.312</b>	<b>742.223</b>	<b>972.376</b>	<b>1 242.047</b>	<b>1 009.206</b>	<b>764.633</b>
+ Depreciation	310.890	321.050	330.502	342.482	357.135	374.625	395.139	418.892
- Capex	456.041	456.041	456.041	501.645	551.810	606.991	667.690	734.459
- Change in working capital	44.935	4.724	9.675	1.088	36.828	41.210	-4.368	-4.516
- Income tax expense	189.248	190.404	195.215	158.171	208.033	269.662	225.993	177.818
FCF	520.096	569.895	588.883	423.801	532.840	698.809	515.030	275.764
<b>DCF</b>	<b>468.086</b>	<b>455.916</b>	<b>471.106</b>	<b>339.041</b>	<b>426.272</b>	<b>559.047</b>	<b>412.024</b>	<b>220.611</b>
<b>WACC</b>	<b>13%</b>							
First stage DCF	3 352.103							
Terminal value	2 124.530							
PV of Terminal value	1 699.624							
Enterprise value (EV)	5 051.727							
Net debt	535.318							
Fair value	4 516.409							
Number of common shares (mn)	715							
<b>Target price, ruble per share</b>	<b>6 317</b>							
Current price, RUB/share	5 450							
Upside	16%							
<b>Rating</b>	<b>BUY</b>							

Source: Company data, Halyk Finance estimates, Bloomberg

Fig. 2. Key assumptions in forecasts

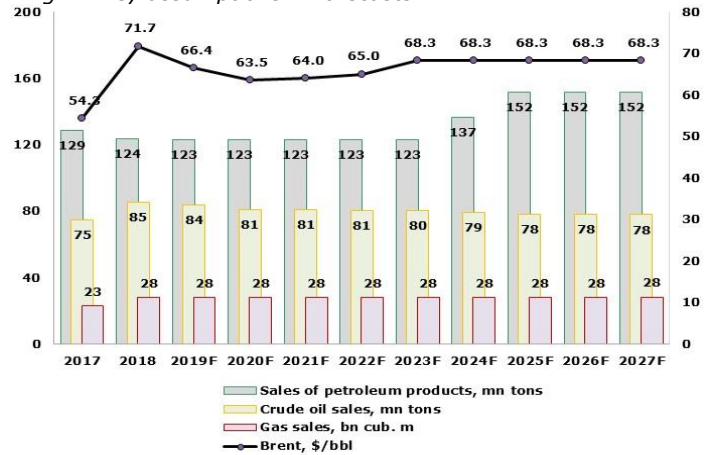


Fig. 4. Sustainability of revenues in the conditions of "cheap" oil due to increased sales of petroleum products

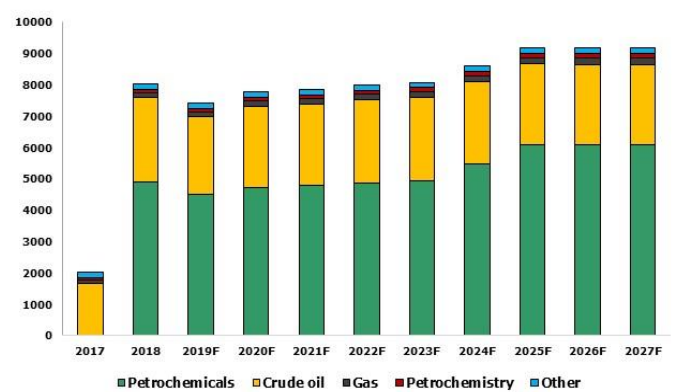
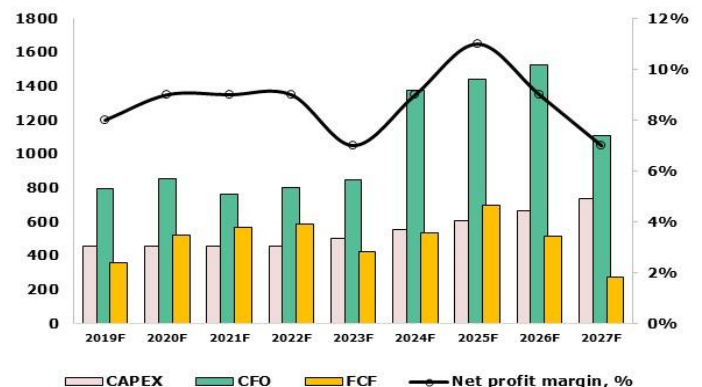


Fig. 6. Consistently positive FCF during 2019-27





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